

# **REPORT ON SALE OF GOODS**

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**ONTARIO LAW REFORM COMMISSION**

**VOLUME II**



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**Ministry of the  
Attorney  
General**

**1979**

MR. JUSTICE OSLER



**REPORT  
ON  
SALE OF GOODS**

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**ONTARIO LAW REFORM COMMISSION**

**VOLUME II**



The Ontario Law Reform Commission was established by section 1 of *The Ontario Law Reform Commission Act* to further the reform of the law, legal procedures and legal institutions. The Commissioners are:

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## LIST OF FREQUENTLY CITED SOURCES AND ABBREVIATIONS

ATIYAH	P. S. Atiyah, <i>The Sale of Goods</i> (5th ed., 1975).
BENJAMIN	<i>Benjamin's Sale of Goods</i> (1st ed., 1974), (Gen. Editor: A. G. Guest).
C.M.A. STATISTICAL RESULTS	"The Canadian Manufacturers' Association Questionnaire and Statistical Results", Research Paper No. I.1.
DRAFT UNCITRAL CONVENTION	Draft Convention on the International Sale of Goods, as adopted by the United Nations Commission on International Trade Law in June, 1977.
DUESENBERG AND KING	R. W. Duesenberg and O. B. King, <i>Sales and Bulk Transfers Under the Uniform Commercial Code</i> (1966).
FRIDMAN	G. H. L. Fridman, <i>Sale of Goods in Canada</i> (1973).
N.S.W. WORKING PAPER	Law Reform Commission, New South Wales, <i>Working Paper on the Sale of Goods</i> (1975).
NYLRC STUDY	State of New York, <i>Report of the Law Revision Commission for 1955; Study of the Uniform Commercial Code</i> (3 vols.)*
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## CHAPTER 12

### THE 'NEMO DAT' DOCTRINE AND SALE TRANSACTIONS

#### 1. INTRODUCTION

It is necessary in every legal system to reconcile the conflict that arises when a seller purports to transfer title of goods that he does not own, or that are subject to an undisclosed security interest, to a person who buys them in good faith and without notice of the defect in title. The alternative means of resolving this conflict are usually stated in terms of a policy favouring security of ownership, as opposed to a policy that favours the safety of commercial transactions. Few, if indeed any, legal systems have committed themselves fully to the adoption of one or other solution. Between these extremes there lies a range of compromise solutions that depend on the nature of the goods, the persons involved, and the type of transaction.

Ontario law also reflects this diversity of approach. Section 22 of *The Sale of Goods Act*<sup>1</sup> reaffirms the common law principle that a buyer acquires no better title to the goods than the seller had: to quote the familiar Latin expression, *nemo dat quod non habet*.<sup>2</sup> In the sales area, however, this principle is subject to a substantial number of exceptions, of which the following are the most important:

1. conduct precluding the true owner of the goods from denying the seller's authority to sell;<sup>3</sup>
2. sale pursuant to any special common law or statutory power of sale, or a sale pursuant to court order;<sup>4</sup>
3. sale under a voidable title;<sup>5</sup>
4. sale by a seller or buyer in possession;<sup>6</sup>

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<sup>1</sup>R.S.O. 1970, c. 421. Section 22 provides as follows:

22. Subject to this Act, where goods are sold by a person who is not the owner thereof and who does not sell them under the authority or with the consent of the owner, the buyer acquires no better title to the goods than the seller had, unless the owner of the goods is by his conduct precluded from denying the seller's authority to sell but nothing in this Act affects,

(a) *The Factors Act* or any enactment enabling the apparent owner of goods to dispose of them as if he were the true owner thereof; or  
(b) the validity of any contract of sale under any special common law or statutory power of sale or under the order of a court of competent jurisdiction.

<sup>2</sup>Hereafter referred to as the *nemo dat* rule, or principle, or doctrine.

<sup>3</sup>*The Sale of Goods Act*, R.S.O. 1970, c. 421, s. 22.

<sup>4</sup>*Ibid.*, s. 22(a) and (b).

<sup>5</sup>*Ibid.*, s. 24.

<sup>6</sup>*Ibid.*, s. 25. The provisions of *The Bills of Sale Act*, R.S.O. 1970, c. 44 as am., and their interaction with section 25(1) of *The Sale of Goods Act*, are considered separately, *infra* this chapter, sec. 2(e).

5. sale by a buyer in possession of a document of title, thus defeating the unpaid seller's right of lien or retention or stoppage *in transitu*;<sup>7</sup>
6. sale by a seller in possession in transactions subject to *The Bills of Sale Act*;<sup>8</sup>
7. sale by a mercantile agent in transactions subject to the provisions of *The Factors Act*;<sup>9</sup>
8. dealings in negotiable warehouse receipts;<sup>10</sup>
9. sales subject to an outstanding security interest in the following circumstances:
  - (a) unperfected security interest;<sup>11</sup>
  - (b) inventory held for sale;<sup>12</sup>
  - (c) goods brought into Ontario from outside the Province;<sup>13</sup> and,
  - (d) sale of chattel paper in ordinary course of business.<sup>14</sup>

With the exception of British Columbia, none of the common law provinces has adopted the doctrine of purchase in *market overt*.<sup>15</sup> Even in British Columbia, the doctrine has remained dormant. The doctrine is expressly excluded by section 23 of the Ontario Sale of Goods Act.

The above exceptions differ widely in their practical importance, their history, and their rationale. Many of them suffer from anomalies of one description or another, or have given rise to difficulties in application or interpretation. One possible approach, therefore, in the revised Sale of Goods Act would be to remove the anomalies and uncertainties, while leaving intact the basic *nemo dat* doctrine. The other, more radical, approach would be to place much more emphasis on protection of the good faith purchaser, and to shift the burden of loss to the owner of the goods

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<sup>7</sup>*The Sale of Goods Act*, R.S.O. 1970, c. 421, s. 45.

<sup>8</sup>*Supra*, footnote 6.

<sup>9</sup>R.S.O. 1970, c. 156.

<sup>10</sup>*The Warehouse Receipts Act*, R.S.O. 1970, c. 489, s. 22.

<sup>11</sup>*The Personal Property Security Act*, R.S.O. 1970, c. 344 as am., s. 22(1)(b).

<sup>12</sup>*Ibid.*, s. 30(1). Compare, *The Conditional Sales Act*, R.S.O. 1970, c. 76 as am., s. 2(3). This Act has now been superseded by *The Personal Property Security Act*.

<sup>13</sup>*The Personal Property Security Act*, footnote 11 *supra*, s. 7; and compare, *The Conditional Sales Act*, footnote 12 *supra*, s. 12.

<sup>14</sup>*The Personal Property Security Act*, footnote 11 *supra*, s. 30(2).

<sup>15</sup>According to this doctrine, where goods are sold in *market overt* in accordance with the usage of the market, a buyer who buys in good faith and without notice of any defect or want of title on the part of the seller, acquires good title. A *market overt* is "an open, public and legally constituted market": see, Fridman, *Sale of Goods in Canada* (1973), at p. 141.

under one of the versions of the *possession vaut titre* principle,<sup>16</sup> which obtains in many civil law jurisdictions. These alternatives will be considered separately in the ensuing discussion.

## 2. THE NEMO DAT DOCTRINE; REMOVING EXISTING ANOMALIES AND UNCERTAINTIES

We now turn our attention to the anomalies and difficulties associated at present with the doctrine of *nemo dat*. It is clear that, if the *possession vaut titre* principle is rejected, some variation of the *nemo dat* rule will continue to apply. Accordingly, in the following discussion, we recommend changes that should be made to the existing law, should it be considered that the *possession vaut titre* principle is inappropriate for Ontario.

### (a) SALES UNDER A VOIDABLE TITLE

An important exception to the *nemo dat* rule is contained in section 24 of the Ontario Sale of Goods Act. Section 24 provides as follows:

24. When the seller of goods has a voidable title thereto but his title has not been avoided at the time of the sale, the buyer acquires a good title to the goods, if he buys them in good faith and without notice of the seller's defective title.

Two principal difficulties have arisen under this exception. The first involves the notoriously difficult distinction between void and voidable sales; that is, those induced by a mistake going to the root of the contract (for example, a mistake as to the identity of the purchaser), and those induced by a mistake not going to the root of the contract.<sup>17</sup> The other arises from the decision of the English Court of Appeal in *Car and Universal Finance Co. v. Caldwell*.<sup>18</sup>

<sup>16</sup>So called after the provision in section 2279 of the French Civil Code. Article 2279 provides as follows:

En fait de meubles, la possession vaut titre.

Néanmoins celui qui a perdu ou auquel il a été volé une chose peut la revendiquer pendant trois ans, à compter du jour de la perte ou du vol contre celui dans les mains duquel il la trouve; sauf à celui-ci son recours contre celui duquel il la tient.

(In matters of personalty, possession is equivalent to title.

Nevertheless, one who has lost or from whom was stolen a thing, may claim it during three years, counting from the day of the loss or theft, against the one in whose hands he finds it, saving to that one his recourse against him from whom he holds it.

See, *The French Civil Code*, translated by John H. Crabb (1977), Art. 2279.)

See, further, *infra* this chapter, sec. 3.

<sup>17</sup>For example, *Cundy v. Lindsay* (1878), 3 App. Cas. 459 (H.L.) (void); *Phillips v. Brooks Ltd.*, [1919] 2 K.B. 243 (voidable); *Ingram v. Little*, [1961] 1 Q.B. 31 (C.A.) (void); *Lewis v. Averay*, [1972] 1 Q.B. 198 (C.A.) (voidable); *Elyatt v. Little*, [1947] 1 D.L.R. 700 (Ont. H.C.J.) (voidable); *Cuff-Waldron Mfg. Co. v. Heald*, [1930] 3 D.L.R. 901 (Sask. C.A.) (void). See, further, Waddams, *The Law of Contracts* (1977), at pp. 178-85.

<sup>18</sup>[1965] 1 Q.B. 525 (C.A.).

Under existing law, where a buyer of goods has a void title — for example, where the sale has been induced by a mistake as to the identity of the buyer — he cannot transfer good title to a third party purchaser. Where, however, the buyer has a voidable title — that is, where the sale has been induced by a mistake not going to the root of the contract — good title can be passed to a third party purchaser under section 24 of *The Sale of Goods Act*. The relevance of the distinction between void and voidable titles in this context has been questioned. The typical fact situation in which it operates may be simply stated. A agrees to sell goods to B, a rogue who passes himself off to A as X, a well known party of some substance. B takes delivery of the goods and purports to resell them to C, an innocent purchaser for value. An action is commenced by A against C for damages for conversion. Should it make any difference to the result of this case if B, instead of passing himself off as X, simply passes himself off as a person of considerable wealth? As Devlin, L.J., trenchantly observed in a leading case,<sup>19</sup> why should “the question whether the defendant should or should not pay the plaintiff damages for conversion depend on voidness or voidability, and upon inferences to be drawn from a conversation in which the defendant took no part”?

The English Law Reform Committee has recommended<sup>20</sup> that the distinction between void and voidable titles should be abolished, and that in all cases the third party should obtain a good title, unless the owner avoided the transaction before the rogue resold the goods. This solution has also been adopted in UCC 2-403(1) which provides, *inter alia*, that when “goods have been delivered under a transaction of purchase the purchaser has [power to transfer a good title to a good faith purchaser for value] even though (a) the transferor was deceived as to the identity of the purchaser”.<sup>21</sup> While this formulation is adequate for the purpose for which it was designed, it is too narrow insofar as it does not extend to other types of common law mistake that affect the validity of the seller’s title. As noted in an earlier chapter,<sup>22</sup> a research paper prepared for the Commission concluded<sup>23</sup> that operative mistakes involving the other contracting party that would make the contract void at common law should be treated as making the contract only voidable. Although we have recommended that the broader question be deferred for future consideration,<sup>24</sup> we support this recommendation<sup>25</sup> in the sales context, so far as it affects the rights of third parties.

It should also be noted that the Law Reform Committee’s recommendation and the Code rule only protect the third party if the owner has intended to transfer title. They will not assist the innocent purchaser where

<sup>19</sup>*Ingram v. Little*, footnote 17 *supra*, at p. 73.

<sup>20</sup>Law Reform Committee, *Twelfth Report (Transfer of Title to Chattels)* (1966), (Cmd. 2958), para. 15.

<sup>21</sup>See, further, Duesenberg and King, *Sales and Bulk Transfers Under the Uniform Commercial Code*, Bender’s Uniform Commercial Code Service, Vol. 3A, pp. 10-39 *et seq.*

<sup>22</sup>*Supra*, ch. 5, sec. 5.

<sup>23</sup>See, McCamus, “Mistake in Contracts for the Sale of Goods”, Research Paper No. II. 8, at p. 79.

<sup>24</sup>*Supra*, ch. 5, sec. 5, p. 107.

<sup>25</sup>See, Draft Bill, s. 6.5(2)(e).

fraudulent possession of the goods was obtained by his seller under another form of transaction, such as a hire-purchase agreement, a leasing agreement, or a simple bailment.<sup>26</sup>

As indicated, the second difficulty arises because of the decision of the English Court of Appeal in *Car and Universal Finance Co. v. Caldwell*.<sup>27</sup> Under existing law,<sup>28</sup> a rogue who has a "voidable" title can transfer good title to a *bona fide* third party purchaser for value, unless the sale is avoided prior to the disposition of the goods to the third party. In the *Caldwell* case, the Court held that, where the fraudulent buyer has disappeared, a substitutional form of notice, such as notification of the police or Automobile Association, is sufficient to rescind the sale. The Law Reform Committee<sup>29</sup> drew attention to the hardship that this decision may cause to third parties, and recommended that the rule should be changed to require notice of rescission to the rogue. It is not easy to see how this recommendation will relieve the hardship to the third party since, *ex hypothesi*, he will not know of the rescission. The Committee thought the third party would be sufficiently protected in the great majority of cases, since it will usually be impractical for the original owner to communicate with the rogue. It seems curious that the third party's position should depend on the accessibility of the rogue.

It appears to us that the Committee failed to come to grips with a more fundamental question: namely, whether it should be necessary that rescission be accompanied by the recovery of possession, and whether, in the meantime, the buyer should retain his power to transfer good title. It may be useful in this context to refer to section 2(2) of *The Factors Act*, which provides that a disposition by a factor in possession of goods with the owner's consent is valid notwithstanding the termination of the consent, so long as the third party was not aware that consent had been terminated. This seems to us to be the correct approach.

In our view, therefore, if the *nemo dat* doctrine is to be retained, the revised Sale of Goods Act should contain the following double-barrelled provision: namely, a provision stating that a purchaser shall be deemed to have a voidable title notwithstanding that the transferor was deceived as to the identity of the purchaser or the presence of some other mistake affecting the validity of the contract of sale; and, a further provision to the effect that a purported avoidance of such a contract shall not affect

<sup>26</sup>Compare, *Central Newbury Car Auctions v. Unity Finance*, [1957] 1 Q.B. 371 (C.A.), involving a *proposed* hire-finance agreement. Presumably, the textual proposition will also apply at common law to a conditional sale agreement. *The Personal Property Security Act*, R.S.O. 1970, c. 344 as am. ss. 1(y) and 2(a), has apparently changed the position, since the seller will now only be deemed to retain a security interest. Even though the seller's interest may have been properly perfected, he may still wish to avoid the agreement in its entirety if he has been induced to enter into it as a result of the buyer's fraud. Hence, the proper characterization of the buyer's interest may be important if the buyer has disposed of the goods before the seller discovered the fraud.

<sup>27</sup>*Supra*, footnote 18. The result in this case was criticized by the Law Reform Committee, footnote 20 *supra*, para. 16. Compare, *Anderson v. Ryan*, [1967] I.R. 34 (H.C.J.).

<sup>28</sup>*The Sale of Goods Act*, section 24.

<sup>29</sup>*Supra*, footnote 20, para. 16.

the position of a third party who has purchased the goods in good faith, unless the goods are recovered by the owner before they are delivered to the third party by the person in possession of the goods.<sup>30</sup>

UCC 2-403(1) also deals with other situations in which a buyer, who may not himself have good title, acquires power to transfer a good title to a good faith purchaser. Subsection (1)(a) covers the situation where the transferor was deceived as to the identity of the purchaser. The other, related, situations in which the buyer can transfer good title are as follows: namely, where

- (b) the delivery [of the goods to the buyer] was in exchange for a check which is later dishonored, or
- (c) it was agreed that the transaction was to be a 'cash sale', or
- (d) the delivery was procured through fraud punishable as larcenous under the criminal law.<sup>31</sup>

These provisions continue and expand the policy of our proposal, set out above. If the *nemo dat* doctrine is to be retained, similar provisions, with appropriate adjustments in language, should be incorporated in the revised Ontario Act.<sup>32</sup>

#### (b) SELLER OR BUYER IN POSSESSION

Subsections (1) and (2) of section 25 of the Ontario Sale of Goods Act also constitute important exceptions to the *nemo dat* doctrine. Section 25 provides as follows:

25.(1) Where a person having sold goods continues or is in possession of the goods or of the documents of title to the goods, the delivery or transfer by that person, or by a mercantile agent acting for him, of the goods or documents of title under a sale, pledge or other disposition thereof to a person receiving the goods or documents of title in good faith and without notice of the previous sale, has the same effect as if the person making the delivery or transfer were expressly authorized by the owner of the goods to make the delivery or transfer.

(2) Where a person having bought or agreed to buy goods obtains, with the consent of the seller, possession of the goods or the documents of title to the goods, the delivery or transfer by that person, or by a mercantile agent acting for him, of the goods or documents of title, under a sale, pledge or other disposition thereof to a person receiving the goods or documents of title in good faith and without notice of any lien or other right of the original seller in respect of the goods, has the same effect as if the person making the

<sup>30</sup>See, Draft Bill, ss. 6.5(2)(a) and (e), 6.8.

<sup>31</sup>The common law treatment of these situations is discussed, *inter alia*, in Duesenberg and King, footnote 21 *supra*, pp. 10-13 *et seq.*; and in Gilmore, "The Commercial Doctrine of Good Faith Purchase" (1954), 63 Yale L.J. 1057.

<sup>32</sup>See, Draft Bill, s. 6.5(2).

delivery or transfer were a mercantile agent in possession of the goods or documents of title with the consent of the owner.

(3) Subject to subsection 5, subsection 2 does not apply to goods the possession of which has been obtained by a buyer under a security agreement whereby the seller retains a security interest within the meaning of *The Personal Property Security Act*, and the rights of the parties shall be determined by that Act.

(4) In this section, 'mercantile agent' means a mercantile agent having, in the customary course of his business as such agent, authority either to sell goods or to consign goods for the purpose of sale, or to buy goods, or to raise money on the security of goods.

(5) Subsection 3 comes into force on a day to be named by the Lieutenant Governor by his proclamation.

Subsections (1) and (2) were copied almost verbatim from subsections (1) and (2) of section 25 of the U.K. *Sale of Goods Act, 1893*,<sup>33</sup> which in turn essentially reproduced sections 8 and 9 of the U.K. *Factors Act*.<sup>34</sup> Thus, the Ontario provisions have a respectably long history. Nevertheless, they raise some basic questions of principle that do not appear to have been adequately explored in the literature or in the case law. Apart from the question of principle, the language of the two subsections has given rise to a substantial number of constructional problems. Other difficulties have also manifested themselves. We deal first with the technical questions.

#### (i) *Technical Questions*

##### (1) *Status of Person in Possession*

Before the decision of the Privy Council in *Pacific Motor Auctions Pty. Ltd. v. Motor Credits (Hire Finance) Ltd.*,<sup>35</sup> the preponderant case law<sup>36</sup> favoured the view that section 25 only applied to cases where the seller or buyer was in possession of the goods in his capacity as seller or buyer, and not in some other capacity such as hirer under a hire-purchase agreement. The Privy Council has now held that a change in the capacity of a seller in possession of goods does not preclude a *bona fide* purchaser

<sup>33</sup>The differences are as follows: (a) section 25(1) of the Ontario Act substitutes "to make the delivery or transfer" for "to make the same" in the last line of the U.K. subsection, and "a sale" for "any sale"; (b), in both subsections (1) and (2), the U.K. Act uses "the same" instead of repeating "the goods or documents of title". Section 25(3) of the Ontario Act has no counterpart in the U.K. Act, since the U.K. has no public registration system for conditional sale agreements. The definition of "mercantile agent" in the Ontario Act, section 25(4), is copied from section 1(1)(c) of *The Factors Act*, R.S.O. 1970, c. 156.

<sup>34</sup>52 & 53 Vict., c. 45 (U.K.). These provisions do not appear in the Ontario *Factors Act*.

<sup>35</sup>[1965] A.C. 867 (P.C.), followed in *Worcester Works Finance Ltd. v. Cooden Engineering Co. Ltd.*, [1972] 1 Q.B. 210 (C.A.).

<sup>36</sup>For example, *Eastern Distributors Ltd. v. Goldring*, [1957] 2 Q.B. 600 (C.A.); *Staffs Motor Guarantee, Ltd. v. British Wagon Co. Ltd.*, [1934] 2 K.B. 305; and compare, *Schafhauser v. Shaffer & National Finance Co.*, [1943] 3 D.L.R. 656 (Sask. C.A.), a decision under the Saskatchewan *Factors Act*, R.S.S. 1940, c. 282. Contrast, *Vowles v. Island Finances Ltd.*, [1940] 4 D.L.R. 357 (B.C.C.A.).

from asserting good title to the goods, unless there has been some interruption in the continuity of the seller's possession. While we welcome the policy of the decision, it may well be asked why a break in the continuity of possession should make all the difference. So far as third parties are concerned, the outward appearances surely remain the same, whether or not there has been an earlier interruption in the continuity of physical possession. It seems to us, therefore, that in approaching the problem anew one should focus attention on the character of the person holding possession. A change in the capacity in which a seller holds goods, or an interruption in physical possession, should not be decisive.<sup>37</sup>

(2) *The Doctrine of Constructive Notice and the Effect of Registration of the Sale Agreement*

It is not entirely clear, under existing law, whether a purchaser of goods from a seller or buyer in possession is bound by the contents of a public register containing entries concerning the ownership of, or any security interest in or claim to, the goods.

In *Joseph v. Lyons*,<sup>38</sup> the English Court of Appeal decided that the equitable doctrine of constructive notice should not be extended to commercial transactions, and that it did not apply to documents registered in fulfillment of the requirements under the U.K. Bills of Sale legislation. The decision is usually treated as a particularized application of the broader principle that doctrines of constructive notice should not be imported into mercantile transactions.<sup>39</sup> The rationale of the *Joseph v. Lyons* decision has been followed in Canada,<sup>40</sup> and applied in circumstances not involving a conflict between competing legal and equitable interests, as was true in that case. On the other hand, this rationale was distinguished by the Saskatchewan Court of Appeal in *Kozak v. Ford Motor Credit Corp.*<sup>41</sup> The grounds of distinction may lack persuasiveness. It is, however, difficult to fault the Court's general conclusion that to refuse to apply the doctrine of constructive notice to the contents of a document whose registration is designed to eliminate secret liens, is inconsistent with the object of registration statutes.

Section 25(3) of the Ontario Sale of Goods Act, which was added in 1967,<sup>42</sup> but which has not yet been proclaimed in force, states that subsection (2) shall not apply where the buyer is in possession pursuant to a

<sup>37</sup>See, Draft Bill, s. 6.6(2)(a).

<sup>38</sup>(1884), 15 Q.B.D. 280 (C.A.).

<sup>39</sup>See, for example, *Manchester Trust v. Furness*, [1895] 2 Q.B. 539 (C.A.), and the cases cited *infra*, footnote 40.

<sup>40</sup>For example, *Traders Finance Corp. Ltd. v. Dawson Implements Ltd.* (1958), 15 D.L.R. (2d) 515 (B.C.S.C.); *Century Credit Corp. v. Richard*, [1962] O.R. 815, (1962) 34 D.L.R. (2d) 291 (C.A.); *General Motors Acceptance Corp. v. Hubbard* (1978), 21 N.B.R. (2d) 49 (N.B.S.C., App. Div.), aff'g 18 N.B.R. (2d) 248 (Q.B.). See, also, LaForest, "Filing under the Conditional Sales Act: is it Notice to Subsequent Purchasers?" (1958), 36 Can. Bar Rev. 387.

<sup>41</sup>(1971), 18 D.L.R. (3d) 735 (Sask. C.A.).

<sup>42</sup>S.O. 1967, c. 89, s. 1.

security agreement governed by *The Personal Property Security Act*.<sup>43</sup> We support this approach, although it appears to us that the wording of the subsection is too restrictive. It does not, for example, cover registration of an absolute bill of sale under *The Bills of Sale Act*. Assuming, therefore, that it is decided to retain the *nemo dat* principle and to reproduce the substance of section 25 in the revised Sale of Goods Act, the equivalent version of section 25(3) should be suitably enlarged.

(3) *Newtons of Wembley v. Williams*<sup>44</sup>

Section 25(1) of *The Sale of Goods Act* deals with the effect of a seller being in possession of goods after title has passed to the buyer; section 25(2) applies to the converse situation of a buyer who obtains possession of goods before title has been transferred.<sup>45</sup> The two subsections are not identically worded but, until *Newtons of Wembley v. Williams*,<sup>46</sup> it was generally assumed<sup>47</sup> that their practical effect was the same. In that case, this assumption was shown to be erroneous. It was held that the rider at the end of subsection (2), (that is, that a disposition by the buyer in possession "has the same effect as if the person making the delivery or transfer were a mercantile agent in possession of the goods or documents of title with the consent of the owner") cannot be ignored. "Mercantile agent" is defined in identical terms in both section 25(4) of *The Sale of Goods Act*, and *The Factors Act*.<sup>48</sup> The latter Act also prescribes, in section 2(1), the powers of such an agent as to disposition of goods. As a result of the wording of section 25(2), the third party must show not only that the buyer in possession sold the goods, but also that, if the buyer in possession had been a factor, the sale would have been a sale in the ordinary course of the factor's business. As the *Williams* decision illustrates, this rendering of the provision leads to at least two important consequences. First, it requires the court to ascribe a hypothetical status, that of a mercantile agent, to the buyer, and to judge his wrongful disposition by an equally hypothetical standard. Secondly, and of equal importance, since

<sup>43</sup>Section 53(1) of *The Personal Property Security Act* provides, however, that registration of a financing statement constitutes notice of the security interest to which it relates to all persons claiming any interest in such collateral during the period of 3 years following such registration. See, also, section 68 of that Act, which provides that, where there is a conflict between *The Personal Property Security Act* and the provisions of any other Act, other than *The Consumer Protection Act*, the provisions of *The Personal Property Security Act* shall prevail. The practical result, therefore, appears to be that section 25(3) of *The Sale of Goods Act* is not essential to protect the interest of a conditional seller out of possession and to exclude the operation of section 25(2).

<sup>44</sup>[1965] 1 Q.B. 560 (C.A.), noted in (1965), 43 Can. Bar Rev. 639. See, also, *Kozak v. Ford Motor Credit Corp.*, footnote 41 *supra*; and contrast, *General Motors Acceptance Corp. v. Hubbard*, footnote 40 *supra*, at pp. 66-68.

<sup>45</sup>The language of section 25(2) is not confined to such cases but, as commentators have frequently noted, it is difficult to envisage situations in which a third party dealing with a buyer who has acquired title from the seller will have to invoke s. 25(2) in order to protect his acquisition of the goods.

<sup>46</sup>[1965] 1 Q.B. 560 (C.A.).

<sup>47</sup>And apparently so held in *Jeffcott v. Andrew Motors Ltd.*, [1960] N.Z.L.R. 721. See, also, *Langmead v. Thyer Rubber Co. Limited*, [1947] S.A.S.R. 29, per Reed, J., at p. 39. These judgments were not referred to in the *Williams* case.

<sup>48</sup>R.S.O. 1970, c. 156, s. 1(c).

the rider inferentially incorporates section 2(2) of *The Factors Act*,<sup>49</sup> the buyer is deemed to remain in possession of the goods or documents of title with the owner's consent, even though possession had been obtained by fraudulent means and the owner/seller had purported to rescind the sale.

As writers have noted,<sup>50</sup> this aspect of the decision reverses the normal rule concerning the avoidance of voidable transactions, and neutralizes the effect of *Car and Universal Finance Co. v. Caldwell*<sup>51</sup> in an important range of transactions. The English Law Reform Committee<sup>52</sup> also criticized this anomaly and recommended its removal. We do not share these misgivings. While we readily support the proposition that subsections (1) and (2) should read alike, as has been indicated earlier the rationale of section 2(2) of *The Factors Act* is, in our view, based on sounder foundations than the Law Reform Committee's approach to the rule in the *Caldwell* case. We would not, therefore, be inclined to deviate from the decision in *Newtons of Wembley v. Williams* on this ground alone.

In our opinion, the valid criticism of section 25(2), as construed in the *Williams* case, is that it introduces into section 25 a double standard for judging the effects of a wrongful disposition by a seller or buyer in possession. In our view, there is no sound functional or conceptual reason for this distinction. It is not clear why it was introduced in the first place. Arguably, the draftsman may have intended to confine subsection (2) to sales made by a buyer in the ordinary course of his business. However, even if that had been the intention, it is not easy to explain why a person buying goods from a seller in possession should be treated more favourably than if his seller were a buyer in possession. We are, therefore, of the view that the distinction should be abolished in any revised version of section 25.<sup>53</sup>

Before leaving this subject, another important discrepancy between section 25(1) and (2) should be noted. Subsection (2) requires the buyer to be in possession with the "consent" of the seller. There is no such requirement in subsection (1) with respect to a seller in possession. In *Worcester Works Finance Ltd. v. Cooden Engineering Co. Ltd.*<sup>54</sup> it was held, *inter alia*, that the distinction was a material one, and that the omission in section 25(1) could not have been accidental. As the decision

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<sup>49</sup>Section 2(2) provides as follows:

Where a mercantile agent has, with the consent of the owner, been in possession of goods or of documents of title to goods, a sale, pledge or other disposition that would have been valid if the consent had continued, is valid notwithstanding the termination of the consent if the person taking under the disposition acts in good faith and has not at the time thereof notice that the consent has been terminated.

<sup>50</sup>For example, Fridman, *Sale of Goods in Canada* (1973), pp. 131-32; Benjamin's *Sale of Goods* (1974), paras. 484-85.

<sup>51</sup>*Supra*, footnote 18.

<sup>52</sup>*Supra*, footnote 20, para. 24.

<sup>53</sup>See, Draft Bill, s. 6.6(1) and (2).

<sup>54</sup>[1972] 1 Q.B. 210 (C.A.). Compare, *Bender v. National Acceptance Corporation Ltd.* (1928), 63 O.L.R. 215 (C.A.).

itself shows, this interpretation can lead to some surprising results, and raises an important question involving the rationale of subsection (1). It is one thing to say that a person who entrusts goods to another, or who acquiesces in the retention of possession of goods by another, should assume the risk of his bailee's dishonesty. It is quite another to burden the bailor with the loss of his chattels if he had no reason to anticipate the risk. Such a result would go even beyond the *possession vaut titre* rule adopted in many civil law jurisdictions. It seems to us important that any revised version of section 25(1) should make it clear that consent by a bailor/buyer to the possession of a bailee/seller is an essential prerequisite to the bailee/seller's power to transfer a better title than he himself has.

(4) *Brandon v. Leckie*<sup>55</sup>

The concluding words of section 25(2) provide that a "sale, pledge or other disposition" by the buyer in possession has the same effect as if he were a mercantile agent in possession of the goods "with the consent of the owner".<sup>56</sup> The issue raised in *Brandon v. Leckie*<sup>57</sup> was whether the word "owner" should be read literally, so that a buyer in possession would be empowered to transfer not only such rights as his immediate seller possessed in the goods, but also the rights of the "owner" where the immediate seller himself lacked title. Moore, J., held, in our view correctly, that the words "seller" and "owner" in section 25(2) should be read interchangeably, and that the concluding words did not have the dramatic effect originally contemplated by Atiyah.<sup>58</sup> But Atiyah and other authors are surely right in drawing attention to the unfortunate wording, which was presumably transposed from the somewhat different context of section 2 of *The Factors Act*. It should be noted that the word "owner" also appears in section 25(1). The use of this word creates an analogous problem in the interpretation of subsection (1). Assuming the retention of the *nemo dat* rule, the ambiguity caused by such terminology in section 25(1) and (2) should be avoided to the extent possible in the revised Act.

(5) *The Meaning of "Sale, Pledge, or Other Disposition"*

The words "sale, pledge or other disposition" appear in both subsections (1) and (2) of section 25 of *The Sale of Goods Act*. "Sale" has a well settled meaning; "pledge" is more equivocal and could be construed as referring to any type of consensual security interest,<sup>59</sup> or as being restricted to a common law pledge in the strict sense. It seems reasonable to assume that the draftsman intended the wider meaning. If it were decided to continue to extend the protection of the section to third parties claiming a security interest in the goods,<sup>60</sup> it would be necessary to

<sup>55</sup>(1972), 29 D.L.R. (3d) 633 (Alta. S.C., Tr. Div.).

<sup>56</sup>Italics added.

<sup>57</sup>*Supra*, footnote 55. See the Comments by Zysblat (1974), 9 U.B.C. L. Rev. 186, and Powles, "Stolen Goods and The Sale of Goods Act 1893, Section 25(2)" (1974), 37 Mod. L. Rev. 213.

<sup>58</sup>Atiyah, *The Sale of Goods* (5th ed., 1975), at pp. 212-13.

<sup>59</sup>As is true of the definition of "pledge" in s. 1(d) of *The Factors Act*.

<sup>60</sup>On this point see, further, *infra*, this ch., sec. 4(e).

clarify the meaning of the word "pledge" in any revised version of section 25.

The main difficulty arises with respect to the meaning of the phrase "or other disposition". Two constructions were advanced in the *Worcester Works Finance* case.<sup>61</sup> Megaw, L.J., thought that, to fall within the section, a disposition must involve "some transfer of an interest in property", as contrasted with a mere transfer of possession.<sup>62</sup> Lord Denning, M.R., preferred a wider construction, and held that "disposition" extends "to all acts by which a new interest (legal or equitable) in the property is effectually created".<sup>63</sup> Presumably, he, too, would exclude a mere possessory interest.

Apart from the question of interpretation, section 25 raises a more fundamental question of policy: namely, whether it should seek to protect all persons dealing in good faith with a seller or buyer in possession, regardless of the character of the subsequent transaction. Alternatively should the protection of the section be confined to specified types of third parties. As will be explained hereafter,<sup>64</sup> for the purposes of the revised Sale of Goods Act, we prefer the narrower approach.

Section 25 is also unsatisfactory from another point of view. It is not clear whether the disposition must be made for valuable consideration. Assuming the retention of the *nemo dat* principle, this question, too, should be clarified in any revised version of the section.<sup>65</sup>

#### (6) *Sales on Approval and Contracts of Sale or Return*

Section 19, Rule 4, provides presumptive rules that determine when the property in goods is deemed to pass to a buyer under a sale on approval or under a contract of sale or return. However, these rules are only presumptive. It is possible for the careful draftsman not only to avoid them but, indeed, to provide that no contract of sale shall come into effect without the seller's prior consent or payment of the price.<sup>66</sup> Apparently, the effect of a provision of the latter type is also to deny a third party dealing in good faith with the bailee in possession of the goods the protection of section 25(2). The reason is that, in such a case, the bailee would not be a "buyer" within the meaning of the Act.<sup>67</sup> This is obviously an unsatisfactory position and raises anew some fundamental questions concerning the scope and rationale of section 25. These questions are dealt with below.<sup>68</sup>

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<sup>61</sup>[1972] 1 Q.B. 210 (C.A.).

<sup>62</sup>*Ibid.*, at p. 220.

<sup>63</sup>*Ibid.*, at p. 218.

<sup>64</sup>*Infra*, this ch., sec. 4(e).

<sup>65</sup>See, Draft Bill, s. 6.6(1).

<sup>66</sup>See, for example, *Pitrie v. Racey* (1963), 37 D.L.R. (2d) 495 (B.C.S.C.); and *Weiner v. Gill*, [1906] 2 K.B. 574 (C.A.).

<sup>67</sup>*Benjamin's Sale of Goods* (1974), para. 529; *Edwards v. Vaughan* (1910), 26 T.L.R. 545 (C.A.).

<sup>68</sup>*Infra*, this ch., sec. 4(b).

## (7) Documents of Title

Both limbs of section 25 apply to documents of title, as well as to goods entrusted to the seller or buyer under a contract of sale. The term "document of title" is broadly defined in section 1(1)(e) of *The Sale of Goods Act*.<sup>69</sup> On the face of it, the assimilation of documents of title to goods seems logical. After all, the definitional premise is that the document is used in the ordinary course of business as proof of the possession or control of the goods. It is, therefore, reasonable for the third party to treat a transfer of the document to him as equivalent to a transfer of possession of the goods. However, there are important difficulties.

The first difficulty, as is explained in a later chapter,<sup>70</sup> is that the term "document of title" and the cognate term "warehouse receipt" are not consistently defined in *The Sale of Goods Act*, *The Warehouse Receipts Act*,<sup>71</sup> *The Mercantile Law Amendment Act*,<sup>72</sup> and *The Personal Property Security Act*.<sup>73</sup> This could lead to significantly different results depending on which definition is being invoked. The second difficulty is that *The Sale of Goods Act* fails to draw a distinction between negotiable and non-negotiable documents of title. *The Warehouse Receipts Act* and *The Personal Property Security Act* both treat the distinction as fundamental, and apply a separate régime of rules to the two types of document. In particular, transfer of a non-negotiable document of title under these statutes does not effect constructive delivery of the goods represented by the document until the bailee of the goods has been notified of the transfer.<sup>74</sup> The practical importance of this requirement is vital. In the case of warehouse receipts governed by *The Warehouse Receipts Act* it means, for example, that the goods may still be subject to levy by the transferor's creditors.<sup>75</sup> In the case of *The Personal Property Security Act*, it leaves the secured party with an unperfected security interest. The question that arises, therefore, is whether greater effect should be given to the transfer of a non-negotiable document of title for the purposes of section 25 than is afforded under the provisions of the other two Acts.

The definition of document of title was adopted in the Ontario Sale of Goods Act long before the enactment of *The Warehouse Receipts Act* and *The Personal Property Security Act*. Nineteenth century English com-

<sup>69</sup>Section 1(1)(e) provides as follows:

'document of title' includes a bill of lading and warehouse receipt as defined by *The Mercantile Law Amendment Act*, any warrant or order for the delivery of goods and any other document used in the ordinary course of business as proof of the possession or control of goods or authorizing or purporting to authorize, either by endorsement or delivery, the possessor of the document to transfer or receive goods thereby represented.

Compare, the definition in section 1.1(1)11 of the Draft Bill.

<sup>70</sup>*Infra*, ch. 13.

<sup>71</sup>R.S.O. 1970, c. 489.

<sup>72</sup>R.S.O. 1970, c. 272.

<sup>73</sup>R.S.O. 1970, c. 344 as am.

<sup>74</sup>*The Warehouse Receipts Act*, ss. 20-21; *The Personal Property Security Act*, s. 28(1).

<sup>75</sup>This inference arises from s. 15 of the Act, particularly if read in conjunction with the provisions of *The Bills of Sale Act*, R.S.O. 1970, c. 44. Compare, UCC 7-504(2) where the position is stated more clearly.

mercial law possessed no systematic theory of documents of title and, with the partial exception of bills of lading, did not attach any incidents of negotiability to a document of title. Even in the case of bills of lading, the incidents were very modest. Ontario law has travelled some distance since then and, by indirection or otherwise, we have in substantial part adopted the American approach, which draws a critical distinction between negotiable and non-negotiable documents of title.

It may be that the same approach should govern the status of documents of title in the revised Sale of Goods Act. We recommend in a later chapter<sup>76</sup> that the law of documents of title in Ontario should be comprehensively examined with a view to its systematic codification, and that Article 7 of the *Uniform Commercial Code* should be studied in order to determine its suitability for adoption in Ontario. This proposed codification would govern all aspects of documents of title, and would supersede *The Warehouse Receipts Act*, and the relevant provisions in *The Mercantile Law Amendment Act* and other enactments, including the provisions in section 25 of *The Sale of Goods Act* relating to documents of title. If a new documents of title law is adopted, then it should also control the effect of an unauthorized disposition by a person in possession of a document of title.<sup>77</sup> Pending this comprehensive review of the Ontario law of documents of title, it seems prudent to retain the reference to documents of title in any revised version of section 25 of *The Sale of Goods Act*, without distinguishing between negotiable and non-negotiable documents of title.<sup>78</sup>

## (ii) *The Broader Questions of Principle*

All the preceding issues, important though they are, are secondary to two broader questions of principle concerning the scope and rationale of section 25. The first question is whether section 25 should continue to apply to both private sales and sales by a merchant. The second question asks whether section 25 should apply in respect of bailees other than sellers and buyers in possession. These questions must now be considered.

As to the first question, section 25 does not distinguish between the different types of seller and buyer; subject to the qualification introduced by *Newtons of Wembley v. Williams*,<sup>79</sup> it is well settled that the third party obtains a good title without regard to whether the person in possession of the goods is a merchant or is acting in a private capacity. It is difficult to reconcile this generous rule with the common law's general adherence to the *nemo dat* principle. Moreover, it may be thought that the rule does not rest on any consistent basis of commercial policy.

<sup>76</sup>*Infra*, ch. 13.

<sup>77</sup>This is the approach adopted in the *Uniform Commercial Code*. UCC 2-403 does not refer to the effect of an entrustment of a document of title, except by cross reference to Article 7. The effect of such an entrustment must be sought in Articles 7 and 9. See, particularly, UCC 7-205, 7-503, and 9-309.

<sup>78</sup>See, Draft Bill, s. 6.2.

<sup>79</sup>*Supra*, footnote 44.

It will be recalled that section 25 of the Ontario Sale of Goods Act is based on section 25 of the U.K. *Sale of Goods Act, 1893*, which, in turn, was based on sections 8 and 9 of the U.K. *Factors Act*. The predecessor of section 8 of the U.K. *Factors Act* was adopted in 1877, following the decision in *Johnson v. Crédit Lyonnais Co.*<sup>80</sup> That case held that the then *Factors Act* did not apply to a seller who was left in possession of a document of title. But the draftsman, in adopting section 8, appears to have overlooked the fact that the pledgee in the *Johnson* case was primarily prejudiced because the seller in possession was also a merchant. It may also be argued that the broad ambit of sections 8 and 9 of the U.K. *Factors Act* departs from the earlier principle of ostensible authority that underlies the common law cases<sup>81</sup> preceding the *Factors Act* and the "trader's" provisions mentioned below.

Our second question concerns an equally significant feature of section 25. It is confined to one category of bailee: namely, buyers and sellers in possession. The section does not embrace other categories of bailment, such as goods held under various types of equipment leases or other forms of near sale, whose commercial importance may now be as great as, or perhaps even greater than, goods entrusted under the more conventional types of agreement. This anomaly can be explained in various ways. First, the obvious point may be made that, since we are dealing with a sales act, its primary concern is with sales transactions. The second explanation is the historical one: near sales transactions were much less important in 1893 than they are today. Again, it may be argued that a seller or buyer who entrusts his goods to the other party to a contract of sale ought to appreciate that he runs a greater risk, and that he creates a greater appearance of false ownership, than does a simple bailor.<sup>82</sup> However, this reasoning is equally applicable where possession is passed to a lessee who holds goods under a long term lease. Finally, rather than extend exceptions to the *nemo dat* rule, it may be said that the well established tradition in Ontario is to impose registration requirements where there is a substantial danger that third parties may be prejudiced by the existence of undisclosed property interests. But this argument proves too much; and militates just as much against the retention of section 25 in its present form, as it does in favour of its extension to other forms of bailment.

On both of these questions we have, therefore, reached the conclusion

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<sup>80</sup>(1877), 3 C.P.D. 32 (C.A.), at pp. 36-7, and 40. The history of the section is traced in *Pacific Motor Auctions Pty. Ltd. v. Motor Credits (Hire Finance) Ltd.*, [1965] A.C. 867 (P.C.), at p. 882.

<sup>81</sup>For example, *Pickering v. Busk* (1812), 15 East 38 (K.B.), at p. 43; *Meggy v. The Imperial Discount Co.* (1878), 3 Q.B.D. 711 (C.A.), per Bramwell, L.J., at p. 717; *Weiner v. Harris*, [1910] 1 K.B. 285 (C.A.), per Farwell, L.J., at p. 295; *Weiner v. Gill*, [1905] 2 K.B. 172, aff'd on other grounds, [1906] 2 K.B. 574 (C.A.), at p. 581; *Brett v. Foorsen* (1907), 7 W.L.R. 13 (Man.); *Commercial Securities Ltd. v. Johnson*, [1931] 1 D.L.R. 861 (B.C.C.A.). See, further, Ziegel, "The Legal Problems of Wholesale Financing of Durable Goods in Canada" (1963), 41 Can. Bar Rev. 54, at pp. 79-83.

<sup>82</sup>Compare, the dissenting judgment of Denning, M.R., in *Central Newbury Car Auctions Ltd. v. Unity Finance Ltd.*, [1957] 1 Q.B. 371 (C.A.).

that whatever historical reasons may explain the present scope of section 25, the position needs to be reviewed. The possible alternatives will be canvassed in later sections of this chapter.

- (c) ENTRUSTED GOODS AND SALES IN ORDINARY COURSE: THE FACTORS ACT, SECTION 2; THE CONDITIONAL SALES ACT, SECTION 2(3) (NOW REPEALED); AND, THE PERSONAL PROPERTY SECURITY ACT, SECTION 30(1)

These three statutory provisions deserve to be considered together. Basically, they express the same commercial policy of protecting purchasers in ordinary course who buy goods from a person in whose hands the goods constitute part of inventory. They are also linked by a common case law lineage,<sup>83</sup> although the common root is sometimes overlooked.

Nevertheless, some important differences remain between the three statutory provisions. Equally important, they leave untouched a significant area of mercantile sales. Section 2 of *The Factors Act*, as the name of the statute implies, is restricted to goods, including documents of title to goods, entrusted to a mercantile agent who sells in the ordinary course of his business as a mercantile agent. The case law shows<sup>84</sup> that the goods must be consigned to the merchant in his capacity as factor, and not in some other capacity. The courts have also developed some fairly strict criteria as to what constitutes a sale in ordinary course. Section 2(3), the trader's section, in the now repealed Conditional Sales Act only applied to a merchant who received the goods under a wholesale conditional sale agreement and received them, moreover, for purposes of resale. Thus, the section did not cover wholesale chattel mortgage agreements or, it would seem, goods received under a wholesale conditional sale for demonstration purposes and not for resale.<sup>85</sup> It was, moreover, unclear whether section 2(3) applied to raw materials intended for processing or fabrication before ultimate sale. *The Conditional Sales Act* has now been repealed, and replaced by *The Personal Property Security Act*. Section 30(1) of *The Personal Property Security Act*<sup>86</sup> eliminates all these restrictions, since it applies to any form of inventory that is subject to a security interest given by the debtor. But the security interest must be given by

<sup>83</sup>See, Ziegel, "The Legal Problems of Wholesale Financing of Durable Goods in Canada" (1963), 41 Can. Bar Rev. 54, at pp. 78-79, citing, *inter alia*, *Walker v. Clay* (1880), 49 L.J.C.P. 560; *Taylor v. McKeand* (1880), 5 C.P.D. 358; *Payne v. Fern* (1881), 6 Q.B.D. 620; and *Dedrick v. Ashdown* (1888), 15 S.C.R. 227.

<sup>84</sup>For example, *Staffs. Motor Guarantee Ltd. v. British Wagon Co. Ltd.*, [1934] 2 K.B. 305; *Eastern Distribution, Ltd. v. Goldring*, [1957] 2 Q.B. 600 (C.A.); *Edwards v. Vaughan* (1910), 26 T.L.R. 545 (C.A.); *Buller & Co. Ltd. v. T. J. Brooks Ltd.* (1930), 142 L.T. 576 (K.B.); *Astley Industrial Trust Ltd. v. Miller*, [1968] 2 All E.R. 36 (C.A.); *Traders Group Ltd. v. Gouthro* (1969), 9 D.L.R. (3d) 387 (N.S.S.C.).

<sup>85</sup>*Dulmage v. Bankers' Financial Corp.*, [1923] 1 D.L.R. 1185 (Ont. C.A.), *aff'g* (1921), 67 D.L.R. 594 (Ont. H.C.J.).

<sup>86</sup>Section 30(1) reads as follows:

A purchaser of goods from a seller who sells the goods in the ordinary course of business takes them free from any security interest therein given by his seller even though it is perfected and the purchaser actually knows of it.

the debtor, and not by an antecedent person in the chain of title in whose hands the goods did not constitute inventory. The concept of entrustment or ostensible authority, therefore, underlies section 30(1), as it underlies the two other provisions, although all of them fall short of embracing a general *market overt* principle.

We believe that the concept of entrustment to a merchant is a viable and coherent exception to the *nemo dat* principle. The streamlined restatement of the essential features of this exception in UCC 2-403(2) and (3) commends itself to us. These subsections read as follows:

2-403.(2) Any entrusting of possession of goods to a merchant who deals in goods of that kind gives him power to transfer all rights of the entruster to a buyer in ordinary course of business.

(3) 'Entrusting' includes any delivery and any acquiescence in retention of possession regardless of any condition expressed between the parties to the delivery or acquiescence and regardless of whether the procurement of the entrusting or the possessor's disposition of the goods have been such as to be larcenous under the criminal law.

These provisions have a number of important features that deserve to be noted.<sup>87</sup> In the first place, the definition of "entrusting" in subsection (3) covers an acquiescence of retention of possession, as well as delivery of goods to a merchant who did not previously possess them. This term, therefore, embraces the two types of situation now covered in section 25(1) and (2) of *The Sale of Goods Act*.<sup>88</sup> Secondly, by virtue of UCC 2-403(2), it is not a necessary requirement that the goods should have been entrusted to the bailee in his capacity as a merchant. What is important is that the bailee should occupy the position of merchant, and that he should purport to dispose of the goods entrusted to him in the ordinary course of his business.

This reading does not emerge clearly from the literal wording of UCC 2-403(2). It is, however, the meaning ascribed to it by influential commentators,<sup>89</sup> and is supported in part by Comment 2 to the section.<sup>90</sup> It will, therefore, be seen that the adoption in Ontario of this provision could considerably enlarge the existing statutory exceptions to the *nemo dat* rule, and could also change the basis upon which protection is af-

<sup>87</sup>For more detailed discussions, see, NYLRC Study, ch. 5, footnote 52, *supra*, pp. (458)-(460); Duesenberg and King, footnote 21 *supra*, pp. 10-51 *et seq.*

<sup>88</sup>The *Uniform Sales Act*, s. 25, contained a provision equivalent to s. 25(1) of the U.K. Act, but no provision comparable to s. 25(2). Article 2 of the Code has neither, but makes do with the entrustment provision in UCC 2-403(2). The rights of creditors of a seller, left in possession of goods that he has sold, are governed by UCC 2-402(1).

<sup>89</sup>See, NYLRC Study, ch. 5 footnote 52, *supra*; and Duesenberg and King, footnote 21 *supra*.

<sup>90</sup>There appears to be a paucity of cases directly on point. See, however, *Litchfield v. Dueitt* (1971), 245 So. 2d. 190 (Miss. Sup. Ct.); *Linwood Harvestore, Inc. v. Cannon* (1967), 235 A 2d 377 (Pa. Sup. Ct.); *Adkins v. Damron* (1959), 324 S.W. (2d) 489 ((Ky. Ct. App.), contrasting the positions under the *Uniform Sales Act* and the Code); and, compare *Gallagher v. Unenrolled Motor Vessel River Queen* (1973), 475 F. 2d 117 (5th Cir.).

forded to the buyer in ordinary course. Although we are not unanimous on the point,<sup>91</sup> a majority of us believes that the extension can be justified. Assuming the retention of the *nemo dat* doctrine, we would so recommend. So far as the person buying the goods from the merchant in good faith is concerned, he is not aware of the circumstances under which the goods were entrusted to his seller. In our view, it is harsh that, as under existing law, he should be penalized for his ignorance. The entruster, on the other hand, is generally likely to know whether or not the bailee to whom he entrusts his goods is also engaged in the business of selling goods of that kind. He ought, therefore, to realize that he is running a calculated risk that the bailee-merchant will dishonestly dispose of the goods; although, in the great majority of cases, the risk will be very small. This is, we think, the type of case in which a simple rule is preferable to one that strives for perfect equity. An alternative solution, as we suggest again later, is to impose a bonding requirement on professional bailees. A revised Sale of Goods Act, is not, however, the proper home for such a requirement.

Another noteworthy feature of the Code provisions is that the protection is limited to a "buyer in ordinary course of business". This expression is extensively defined in UCC 1-201(9).<sup>92</sup> It does not cover the creation of a security interest or, read literally, any disposition falling short of a full transfer of title. UCC 2-403(2) and (3), therefore, depart significantly from the range of transactions protected by *The Factors Act* and section 25 of *The Sale of Goods Act*, which speak of "sale, pledge or other disposition". On the other hand, UCC 2-403(2) and (3) are consistent with the trader's provision in the now repealed Conditional Sales Act, and section 30(1) of *The Personal Property Security Act*. The exclusion of security transactions can, as we explain later, be justified. The same cannot, however, readily be said of other forms of disposition, such as leasing agreements, that are made in ordinary course but do not involve a transfer of title. Transactions of this nature are, surely, also entitled to protection. Should the *nemo dat* doctrine be retained, we would recommend that the protection of the provision in the revised Act comparable to UCC 2-403(2) be extended to lessees in the ordinary course of business.<sup>93</sup>

If the revised Act were to contain a provision comparable to UCC 2-403, consideration would have to be given to the future of *The Factors*

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<sup>91</sup>One of the Commissioners, the Honourable J. C. McRuer, dissents from this recommendation. His view is that such a provision would give a thief power to pass a good title to personal property. For example, if A left an article which to him was priceless, such as an antique clock or a work of art, with a merchant who dealt in clocks or works of art, to be cleaned or repaired, and an employee, either fraudulently or negligently, sold the article to a purchaser who took in good faith, the owner would have no recourse to recover the article. However, if the owner were given a right in such a case to recover the article by paying the purchase price paid by the holder, with a right to claim over against the merchant, equal justice would be done. In Mr. McRuer's view, section 6.7 of the Draft Bill should be deleted, and section 6.9 amended accordingly.

<sup>92</sup>We have followed the Code definition in s. 1.1(1)5 of the Draft Bill.

<sup>93</sup>See, Draft Bill, s. 6.7(1).

*Act*. There may be a substantial overlap between the two Acts, and *The Factors Act* may not be worth retaining. We have not examined *The Factors Act* in detail, and therefore are not in a position to offer a recommendation. If it is decided to repeal the Act, care should be taken to ensure that those of its features that will be helpful in complementing the new sales provisions are incorporated in the revised Act. We believe this to be particularly true of section 2(2) of *The Factors Act*, which deals with the effect of revocation by the owner of consent to possession by the mercantile agent.

(d) REGISTRATION REQUIREMENTS, GRACE PERIODS, AND  
TEMPORARILY PERFECTED SECURITY INTERESTS

The registration statutes,<sup>94</sup> now largely superseded in Ontario by *The Personal Property Security Act*, are important for a number of reasons. First, they suggest an equitable means of reconciling the conflicting interests of owners and innocent purchasers. Secondly, they raise the question whether registration requirements should be enlarged to embrace a range of transactions wider than secured transactions and absolute assignments of accounts caught by *The Personal Property Security Act*.<sup>95</sup> Thirdly, in terms of policy and drafting techniques, the registration statutes raise the question whether grace periods<sup>96</sup> and periods of temporary perfection should be permitted to prejudice the rights of innocent purchasers. We do not pursue the last two questions. They are currently being reviewed by the Advisory Committee on *The Personal Property Security Act* as part of its general review of the Act.

As to the first question, we have earlier made reference to section 25(3) of *The Sale of Goods Act*. This subsection, which has not yet been proclaimed in force, provides that subsection (2) of section 25 dealing with the protection of third parties who purchase goods from buyers in possession, does not apply where the buyer is in possession pursuant to a security agreement governed by *The Personal Property Security Act*. We have previously recommended that, should the *nemo dat* doctrine be retained, the revised Act should incorporate an expanded version of section 25(3). We would, however, draw attention to an important, and perhaps largely unavoidable, weakness in the registration mechanism of *The Personal Property Security Act*. This weakness, we might add, was

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<sup>94</sup>Namely, *The Assignment of Book Debts Act*, R.S.O. 1970, c. 33; *The Bills of Sale and Chattel Mortgages Act*, R.S.O. 1970, c. 45; *The Bills of Sale Act*, R.S.O. 1970, c. 44; *The Conditional Sales Act*, R.S.O. 1970, c. 76; and, *The Corporation Securities Registration Act*, R.S.O. 1970, c. 88.

<sup>95</sup>Section 2.

<sup>96</sup>That is, the period allowed a secured party to perfect his security interest before it can be successfully challenged. The earlier registration Acts gave rise to a substantial conflict of interpretation which, to some extent, may still subsist. See, for example, *Hulbert v. Peterson* (1905), 36 S.C.R. 324, followed, *inter alia*, in *Reick v. Neeb*, [1948] O.R. 459 (C.A.); *Klimove v. General Motors Acceptance Corp.* (1955), 14 W.W.R. (N.S.) 463 (Alta. S.C., App. Div.); and, *Re Union Acceptance Corp. Ltd.* (1955), 14 W.W.R. (N.S.) 703 (Alta. S.C., Tr. Div.). (The *Hulbert* case was distinguished in *Re Traders Finance Corp.* (1954), 12 W.W.R. (N.S.) 546 (Alta. Dist. Ct.)); and *Industrial Acceptance Corp. Ltd. v. Munro and Parker*, [1950] O.R. 130 (H.C.J.).

also shared by its predecessors. With one exception relating to motor vehicles classified as consumer goods,<sup>97</sup> the financing statement is registered, not against the collateral, but under the name of the debtor. If, therefore, the collateral has passed through a succession of hands, it is quite possible that a search against its present owner will fail to disclose a security interest granted by a previous owner. The problem is particularly acute in the case of non-consumer motor vehicles.

As long ago as 1955, a Select Committee of the Ontario Legislature recommended the adoption of a certificate of title law for motor vehicles, and actually drafted a bill.<sup>98</sup> The project did not proceed and, we understand, is not likely to be revived. Happily, a compromise solution has been found under *The Personal Property Security Act* in the case of security interests in those motor vehicles classified as consumer goods. In such cases, the financing statement must describe the vehicle and must also provide its serial number.<sup>99</sup> Moreover, since 1977, it has been possible to search for security interests against such a vehicle by providing its description. Although these developments represent a marked improvement, there is still an important gap. The mandatory requirements do not apply to non-consumer vehicles.<sup>100</sup> It is, therefore, entirely possible that a search against a vehicle currently used for consumer purposes may not disclose a valid security interest because the vehicle was previously used for non-consumer purposes. We appreciate the difficulty of imposing description requirements for all vehicles serving as collateral under the Act,<sup>101</sup> and we know that there is an awareness of this problem. We urge, however, that the search for an acceptable solution be continued.<sup>102</sup>

(e) THE BILLS OF SALE ACT<sup>103</sup>

When *The Personal Property Security Act* was proclaimed in April 1976, *The Bills of Sale and Chattel Mortgages Act* was repealed, and *The Bills of Sale Act* took its place. This Act provides,<sup>104</sup> *inter alia*, that every sale of goods, not accompanied by an immediate delivery and fol-

<sup>97</sup>See, O. Reg. 879/75, s. 3(2)(a).

<sup>98</sup>See, Select Committee on Central Registration of Documents of Title and Pledge Respecting Chattels and Certificates of Title of Ownership of Motor Vehicles, *Report to the Ontario Legislature* (Queen's Printer, 1955 and 1956). For further details see, Goode & Zeigel, *Hire-Purchase and Conditional Sale: A Comparative Survey of Commonwealth and American Law* (1965), pp. 166-68.

<sup>99</sup>*Supra*, footnote 97.

<sup>100</sup>A secured party may, however, voluntarily provide such information on the financing statement, and it will then be recorded in the system: see, footnote 97 *supra*, s. 3(2)(b).

<sup>101</sup>The difficulty arises principally in inventory financing arrangements and in equipment financing agreements with an after-acquired property clause. In both of these cases, the inventory of vehicles serving as collateral will fluctuate widely from time to time and cannot be identified at the time of the agreement.

<sup>102</sup>If the problem is sufficiently serious, one possibility would be to extend the scope of the assurance fund. Another would be to provide special protection for consumer buyers of such vehicles. These are, however, only suggestions, and should not be construed as recommendations on our part.

<sup>103</sup>R.S.O. 1970, c. 44, as am.

<sup>104</sup>See, section 3.

lowed by an actual and continued change of possession of the goods sold, is void as against creditors of the seller and subsequent buyers and mortgagees in good faith, unless the sale is evidenced by a bill of sale that is registered in accordance with the requirements of the Act. The question that requires consideration is whether this Act is still needed, or whether it has outlived its usefulness.

Hostility towards secret bills of sale not accompanied by possession of the goods goes back to Lord Coke's day.<sup>105</sup> Creditors saw them as transactions contrived to deny creditors their just claims and to conceal the grantor's precarious financial position.<sup>106</sup> Many American state courts treated secret bills of sale as conclusively or presumptively fraudulent. Many more common law jurisdictions adopted legislation requiring the registration of absolute and conditional bills of sale, on pain of avoidance if they were not registered. Ontario adopted a registration requirement for conditional bills of sale (that is, chattel mortgages) as early as 1849, and extended this requirement to absolute bills in 1850.<sup>107</sup> Until its repeal in 1976, *The Bills of Sale and Chattel Mortgages Act* covered both chattel mortgages and absolute sales. *The Personal Property Security Act* was only intended, with minor exceptions, to apply to security interests in personal property and fixtures. Hence, absolute sales, whether or not the seller remains in possession of the goods, are outside the Act and continue to be governed by *The Bills of Sale Act*.

The question whether *The Bills of Sale Act* should be repealed is not a new one. It was considered by the Advisory Committee on The Personal Property Security Act before *The Bills of Sale Act* was proclaimed. The Committee advised against its proclamation.<sup>108</sup> However, an ad hoc Committee of the Commercial Law Subsection of the Ontario Branch of the Canadian Bar Association, whose views were also solicited, reached the opposite conclusion.<sup>109</sup> In the result, the Act was proclaimed. The reasons advanced by the ad hoc Committee of the Bar Association were unusual. It wished to retain the Act, not so much for the protection of creditors and other third parties dealing with the seller in possession, but to protect the *buyer* out of possession against the effect of section 25(1) of *The Sale of Goods Act*. The Committee apparently made the possibly unwarranted assumption that registration of a bill of sale would constitute con-

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<sup>105</sup>See, *Twyne's Case* (1613), 3 Coke 80b, 76 E.R. 809 (K.B.).

<sup>106</sup>Compare, *Cookson v. Swire* (1884), 9 A.C. 653 (H.L.), at pp. 664-65.

<sup>107</sup>(1850), 13 & 14 Vict., c. 62 (Can.). The two Acts were consolidated in 1857 by *An Act to Amend the Statutes of this Province Respecting Mortgages and Sales of Property, and to Consolidate the Same* (1857), 20 Vict., c. 3 (Can.). There are, and apparently have been from the beginning, important differences between the Ontario legislation and the U.K. Bills of Sale Acts. In particular the U.K. Acts do not apply to oral sales or to sales made in the ordinary course of business: see, (1878), 41 & 42 Vict., c. 31(U.K.), s. 4; (1882), 45 & 46 Vict., c. 43, s. 9.

<sup>108</sup>So far as we are aware, the Committee's opinion was not made public.

<sup>109</sup>*Report of ad hoc Committee of Commercial Law Subsection of Canadian Bar Association* (Unpublished, March 11, 1977).

structive notice of the buyer's title. We sympathize with the Committee's concerns, but feel that these concerns can be met much more simply than by retention of the cumbersome machinery of *The Bills of Sale Act*.

The inquiries of our Research Team have shown that the registration requirements of *The Bills of Sale Act* are widely ignored. In the summer of 1976, for example, only about 110 bills of sale were being registered monthly in Toronto, although the number of sales technically subject to the Act must have been much larger. The number of searches was equally modest: about 15 a week compared with a *daily* figure of 250 Personal Property Security Act searches channeled through the Toronto registry. It seems reasonable to conclude, therefore, that *The Bills of Sale Act* has lost most of its practical significance. This impression is confirmed by several trustees in bankruptcy with whom the Research Team has discussed the question. Commercial transactions have changed significantly since the last century, and it is no longer unusual for a seller to remain in possession of the goods for at least a short period before they are delivered to the buyer. The Research Team's inquiries have revealed no opposition among trustees in bankruptcy or lenders to repeal of *The Bills of Sale Act*. In our view the Act may safely be repealed, and we so recommend.

This recommendation still leaves at large the concern of the ad hoc Canadian Bar Association Committee. We believe this concern to be legitimate. We have earlier approved the approach adopted in section 25(3) of the existing Sale of Goods Act, which enables conditional sellers to protect themselves against the effects of section 25(2) of *The Sale of Goods Act* by perfecting their security interest pursuant to *The Personal Property Security Act*. There is no good reason, in our view, why similar protection should be denied to buyers out of possession. Admittedly, this will impose an obligation on third parties dealing with the seller in possession to search the personal property security register for outstanding interests; but they would have to do this in any event with respect to existing security interests.

Assuming retention of the *nemo dat* doctrine, therefore, and assuming, also, repeal of *The Bills of Sale Act*, we recommend<sup>110</sup> that the provisions of the section in the revised Act comparable to section 25 of the existing Act should not apply to security interests governed by *The Personal Property Security Act*.<sup>111</sup> Nor should this section apply where, prior to the disposition by a seller or buyer in possession, a notice in the prescribed form has been registered under *The Personal Property Security*

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<sup>110</sup>See, Draft Bill, s. 6.6(3)(a).

<sup>111</sup>*The Personal Property Security Act* would clearly apply where the buyer is in possession of the goods pursuant to a security agreement, typically a conditional sale agreement. Theoretically, the Act could also apply where a seller purports to give a security interest in goods being manufactured by him, before title is deemed to pass, to a buyer who wishes to obtain some security for advance payment. To cover this type of situation, however rare it is likely to be in practice, section 6.6(3)(a) of our Draft Bill refers to a security interest created in favour of a buyer *or* seller. On the problems of the buyer out of possession who makes advance payment, see, further, *infra*, ch. 17.

*Act*.<sup>112</sup> It should be clearly understood, however, that, pursuant to our recommendation concerning entrustment of goods to a merchant, filing of such a notice will not assist the buyer out of possession, where the seller re-sells the goods in the ordinary course of his business.<sup>113</sup>

(f) SOME TENTATIVE CONCLUSIONS

It may be useful at this point to abstract some general principles from the congeries of exceptions to the *nemo dat* rule in Ontario law discussed in the preceding pages. The following conclusions appear to be warranted.

- (1) None of the exceptions purports to protect the purchaser of lost or stolen goods.
- (2) There is a clear trend in favour of a limited *market overt* principle: that is, where goods are sold in ordinary course by a person to whom they have been entrusted by their rightful owner, or where such goods are subject to a security interest created by the seller.
- (3) Principles of negligence or the absence of due care appear so far to have played no role in the resolution of ownership conflicts arising solely from the entrustment of goods.
- (4) The only exceptions that support the adoption of a general *possession vaut titre* principle are those represented by section 25(1) and (2) of *The Sale of Goods Act*. But there is little evidence that the U.K. Parliament, in enacting section 25 of the *Sale of Goods Act, 1893*, consciously leaned towards the civilian model. Even if there were such evidence, it would be difficult to justify restricting the principle to goods left in the possession of a buyer or seller.
- (5) Through the generous use of registration requirements, Ontario law has evinced a clear policy of favouring a middle ground. The middle ground is, at least in theory, designed to provide third parties with reasonable means of protection, without exposing owners and secured parties to the hazards of the insolvency or dishonesty of the persons to whom they entrust their goods. The question left unanswered concerns the policy that should be adopted in those cases where a registration requirement is not practicable.

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<sup>112</sup>See, Draft Bill, s. 6.6(3)(b). It will be observed that section 6.6(3)(b) provides for the filing of a notice under *The Personal Property Security Act* without distinguishing between a buyer or seller out of possession. We have thought it desirable to extend this facility to both buyers and sellers out of possession because, in view of our recommendations, there may be circumstances in which the buyer in possession will not be a debtor within the meaning of *The Personal Property Security Act*, and that Act will not apply. This will be true, for example, where the buyer is merely a "prospective" buyer, who holds goods on approval or whose offer to buy is subject to acceptance or the fulfilment of some other condition.

<sup>113</sup>See the opening words of our Draft Bill, s. 6.7(1), "Notwithstanding section 6.6 . . .".

We proceed now to discuss the basic changes that should be made in the above framework, either by extending, or by narrowing, the existing exceptions to the *nemo dat* rule.

### 3. SHOULD ONTARIO ADOPT A GENERAL POSSESSION VAUT TITRE RULE?

#### (a) THE CIVIL LAW POSITION<sup>114</sup>

When reform of the law is contemplated, one obvious alternative is to strive for greater simplicity in the current position. This could be accomplished by replacing the *nemo dat* principle, and its exceptions, by the principle found in many civil law jurisdictions that a person in possession of goods can confer a better title to them than he himself has. This is the principle that is enshrined in Article 2279 of the Napoleonic Civil Code,<sup>115</sup> and that has been adopted by a large number of civil law countries. The most significant difference between these jurisdictions is in the extent to which they apply the principle to lost or stolen goods. In French law,<sup>116</sup> the owner is generally entitled to recover lost or stolen goods, except where the goods have been purchased by a third party at a fair or market, at a public sale, or from a merchant dealing in goods of that description. In such a case, the owner can only reclaim the goods upon reimbursing the good faith purchaser the price paid by him for the goods. The *possession vaut titre* principle is also the basis of a draft uniform law on the protection of the *bona fide* purchaser of corporeal movables in international transactions, adopted by UNIDROIT in 1974.<sup>117</sup>

On the other hand, the scope of the *possession vaut titre* principle has been substantially reduced in the Quebec Civil Code. The principle only applies in the case of goods bought in good faith at a fair or market, at a public sale, or from a trader dealing in similar articles, and "in commercial matters generally".<sup>118</sup> In other cases, the possession of goods merely creates a rebuttable presumption of title.<sup>119</sup> The Quebec provisions follow French law with respect to the owner's right to recover lost or stolen goods.<sup>120</sup> These aspects of the Civil Code have been intensively examined by the Civil Code Revision Office and its committees,<sup>121</sup> and they may therefore be changed when a new Civil Code is adopted in Quebec.

<sup>114</sup>A brief description of the civil law position appears in Sauveplanne, "La Protection de l'Acquéreur de Bonne Foi d'Objets Mobiliers Corporels" in UNIDROIT, *Unification of Law Yearbook 1961* (1962), pp. 43 *et seq.* See also Franklin, "Security of Acquisition and of Transaction: *La Possession Vaut Titre* and *Bona Fide* Purchase" (1932), 6 Tul. L. Rev. 589.

<sup>115</sup>That is, "en fait de meubles, possession vaut titre". See, *supra*, footnote 16.

<sup>116</sup>Code Civil, Arts. 2279-2280.

<sup>117</sup>*Report by the Secretariat of UNIDROIT on the 3rd Session* (July, 1974), Study XLV, Doc. 56. We are indebted to M. Michel Hétu of the Federal Department of Justice for providing us with a copy of this and other UNIDROIT documents relating to the project.

<sup>118</sup>Que. C. Civ., art. 2268, para. 3; and compare, art. 1488.

<sup>119</sup>*Ibid.*, art. 2268, para. 1.

<sup>120</sup>*Ibid.*, art. 1489, and art. 2268, para. 4.

<sup>121</sup>For example, Civil Code Revision Office, *Report on Sale* (1975), Report No. XXXI, pp. 37, 69. Substantial changes appear to be envisaged in the revised Civil Code: see, Civil Code Revision Office, *Report on the Quebec Civil Code* (1977), Vol. I, pp. 392, 561, and Vol. II, pp. 696, 915-16.

(b) ARGUMENTS FOR AND AGAINST THE ADOPTION OF THE  
POSSESSION VAUT TITRE RULE IN ONTARIO

As previously noted, existing provisions of *The Factors Act* and *The Personal Property Security Act*, as well as a substantial body of case law, already favour a specialized aspect of the *possession vaut titre* rule (that is, a limited *market overt* principle) where goods are entrusted to a person who disposes of them in the ordinary course of his business. So too, we have seen that UCC 2-403(2) has adopted and restated the entrustment rule, but in somewhat broader language. It should also be noted that the English Law Reform Committee<sup>122</sup> favoured the abolition of the *market overt* rule, which is part of English law, and its replacement by a new provision protecting good faith purchasers of goods bought in ordinary course at retail premises. This recommendation is not restricted to goods entrusted by the owner to a merchant, but it will, of course, include such situations.

The essential issue, therefore, is whether the mercantile rule should be extended to cover *all* forms of entrustment of goods, whether to a merchant or any other kind of person. The Law Reform Committee was opposed to such an extension because of the hardship it would cause to bailors who might not appreciate the risks they were running in entrusting their goods to a non-merchant bailee. To quote the Committee:<sup>123</sup>

. . . it would have repercussions on a large variety of transactions of daily occurrence, such as the sending of goods to the laundry or the deposit of luggage in a station cloakroom, and we think it would generally be regarded as unsatisfactory if in cases of this kind the interests of the true owner were to be subordinated to those of the purchaser from the bailee.

We have reached the same conclusion as the Committee, but on somewhat broader grounds.

In the first place, we are not satisfied that a persuasive case has been advanced for making the entruster of goods to a non-merchant an insurer of the bailee's honesty, assuming that the owner has exercised reasonable care in the entrustment of his goods. The position is not the same as in the entrustment of goods to a merchant. The merchant is invested with an ostensible authority to deal with the goods, and it has generally been assumed that it would seriously impede the security of transactions to expect a buyer in ordinary course to investigate the origin of the goods and the merchant's authority to deal with them. These considerations do not apply in the case of entrustment of goods to non-merchants. There is no holding out by the owner, and commerce is not impeded. Admittedly, the third party may suffer a loss, but the loss derives from the fact that he thought he was dealing with an honest seller. At best the equities are even, and the loss should be divided equally between the owner and the third party, excluding, once again, any issue of negligence. However, apportionment

<sup>122</sup>*Supra*, footnote 20, paras. 30-35.

<sup>123</sup>*Ibid.*, para. 29.

principles have so far found little support in title cases where both parties are equally innocent.

Secondly, we have found no significant support in favour of a general adoption of the civil law principle; nor do we know enough about its practical operation in those jurisdictions that have adopted this principle. Finally, there is no evidence that conversions by simple bailees constitute a significant problem.<sup>124</sup> Other than in a business context, it is not customary to entrust valuable goods to complete strangers. If the bailee has a fixed place of business — a warehouseman, for example, or a drycleaner — he has little to gain by becoming dishonest. He can be caught too easily. Moreover, the goods are frequently of a used character, and have no ready market. To the extent that there is a serious risk that a professional bailee will dishonestly dispose of the goods, a preferable route would be to protect *both* the owner and the third party by imposing licensing or bonding requirements, or both.

There is one possible qualification to the above observations. This qualification concerns goods, particularly motor vehicles, entrusted under a conditional sale or other form of security agreement to a buyer who wrongfully disposes of the goods, within or outside the province of original purchase, without disclosing the outstanding security interest. Such transactions are covered by the registration requirements of *The Personal Property Security Act*.<sup>125</sup> It may be that third parties are not always sufficiently aware of the need to search for liens and that, as previously discussed, the registration mechanism may need improvement. In any event, we do not think this particular problem provides sufficient justification for any general reversal of the *nemo dat* doctrine. Rather, it should be resolved within the context of *The Personal Property Security Act*.

#### 4. REJECTION OF POSSESSION VAUT TITRE; AFFIRMATION OF NEMO DAT

Having rejected a general *possession vaut titre* rule, we are of the view that the basic *nemo dat* doctrine should be affirmed. The existing exceptions to the *nemo dat* doctrine found in sections 22, 24, and 25 of *The Sale of Goods Act* should be retained, subject to the expansion of one of the exceptions in section 22, and subject, also, to the removal of anomalies and technical difficulties set out in detail in section 2 of this chapter. Moreover, as we have indicated, a new exception along the lines of UCC 2-403(2) and (3) should be created in the case of entrustment of goods to a merchant who deals in goods of the kind entrusted.

We discuss these conclusions and some of the issues raised in section 2 of this chapter at greater length below. In addition, our detailed recom-

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<sup>124</sup>We are aware, of course, that there is a high incidence of theft (in the common law sense, as opposed to the definition in section 283 of the Canadian *Criminal Code*) of goods of many kinds. For example, the Metropolitan Toronto Police *Annual Statistical Report* (1973), indicates that in 1973, 6714 automobiles and trucks, 359 motorcycles and snow vehicles, and 8219 bicycles were stolen in Toronto. But this has no bearing on the allocation of risk arising from the entrustment of goods, and raises an entirely different issue.

<sup>125</sup>See, R.S.O. 1970, c. 344 as am., ss. 6, 7.

mendations are set out in our summary of recommendations at the end of this chapter.

(a) SALES UNDER A VOIDABLE TITLE

We are of the view that the exception to the *nemo dat* doctrine contained in section 24 of the existing Sale of Goods Act should be carried forward into the revised Act. In section 2(a) of this chapter we discussed the problems relating to this exception. Having decided that the *nemo dat* doctrine should be retained, we adopt the recommendations previously made with respect to the abolition of the distinction between void and voidable titles and with respect to the avoidance of the contract of sale by the owner of the goods.<sup>126</sup>

(b) SHOULD SECTION 25 OF THE SALE OF GOODS ACT BE REPEALED?

If one rejects the general adoption of a *possession vaut titre* principle where goods are entrusted to or retained by a non-merchant, it may appear anomalous to retain section 25 of *The Sale of Goods Act*, which deals with goods held by a seller or buyer and which, essentially, reflects the *possession vaut titre* principle. Nevertheless, after careful consideration, we have decided to recommend that the revised Act should contain a provision comparable to section 25 of the existing Act. Such a provision would, of course, incorporate the recommendations of a technical nature that have been made in section 2(b) of this chapter.

Our reasons for recommending the incorporation in the revised Act of a provision comparable to section 25 are several. Section 25 has been part of our law for over fifty years. The protection of good faith purchasers from a seller in possession goes back even farther, and has been a feature of Ontario's Bills of Sale legislation for over a hundred years. Moreover, in accordance with our earlier proposals, the seller or buyer out of possession, as the case may be, will be able to protect himself by filing under *The Personal Property Security Act*. Further, there is a widely perceived difference between entrusting goods to a simple bailee, and entrusting them to a person who was their owner or is expected to become their owner under the terms of the entrustment.

We recognize, however, that if compromise and tradition dictate the retention of section 25, the restriction of section 25(2) to a buyer in possession, in the strict sense of the term, should be relaxed in favour of prospective buyers; that is, those persons who, under the terms of the agreement, have an option, or have offered, to buy the goods. We so recommend.<sup>127</sup> For this purpose, "prospective buyer" should be defined in the following way: (a) as a person who receives the goods under a sale on approval or contract of sale or return,<sup>128</sup> or with an option to purchase;<sup>129</sup> and, (b) as a person whose offer to buy the goods has been

<sup>126</sup>See, Draft Bill, ss. 6.5 and 6.8.

<sup>127</sup>See, Draft Bill, s. 6.6(1), (2) and (4).

<sup>128</sup>For the existing position, see *supra*, this chapter, section 2(b)(6).

<sup>129</sup>Compare, *The Conditional Sales Act* (now repealed), ss. 1(d), 2(2), which also applied to bailments with an option to purchase.

accepted, subject to the approval of a third person or the fulfillment of some other condition.<sup>130</sup> These extensions appear to be so closely related to a contract of sale that they ought reasonably to be embraced by the underlying policy of section 25.

(c) SHOULD OWNERS OF GOODS BE SUBJECT TO A DUTY OF REASONABLE CARE WITH RESPECT TO THEIR ENTRUSTMENT?

We have rejected the adoption of a general *possession vaut titre* principle. This rejection does not, however, answer the question whether, where a third party cannot rely on one of the exceptions to the *nemo dat* rule, an owner should be precluded from asserting his title where he has been negligent in the entrustment of his goods. In *Ingram v. Little*,<sup>131</sup> Devlin, L.J., suggested such an approach,<sup>132</sup> although it is not clear whether he would restrict the duty of care to sales procured by fraudulent means. Assuming the principle itself to be worthy of serious consideration, however, there does not appear to be any justification for restricting the duty to these types of entrustment and purchase.

We believe an owner of goods ought to be under a duty of reasonable care in respect of their entrustment.<sup>133</sup> Conduct precluding an owner from asserting his title is already recognized in section 22 of *The Sale of Goods Act*, although, until now, this provision has been construed very narrowly by the courts.<sup>134</sup> Again, a duty of care has been accepted by the courts, in at least some circumstances, with respect to the execution of negotiable instruments.<sup>135</sup> This duty was extended, albeit very cautiously, to the entrustment of other types of instrument in *Mercantile Credit Co. Ltd. v. Hamblin*,<sup>136</sup> and was given strong approval by the House of Lords in *Saunders v. Anglia Building Society*<sup>137</sup> with respect to a plea of *non est factum*. We see no good reason why, in the modern milieu, the duty should be restricted to the execution and transfer of documents. Nor do we believe that the imposition of a duty of care would impose unreasonable burdens on owners and purchasers of goods. We are not of the view that breach of such a duty should result in an owner being held liable in damages for failing to exercise reasonable care.<sup>138</sup> It is surely a

<sup>130</sup>As illustrated, in the context of a hire-purchase agreement, by *Central Newbury Car Auctions Ltd. v. Unity Finance Ltd.*, [1957] 1 Q.B. 371 (C.A.).

<sup>131</sup>[1961] 1 Q.B. 31 (C.A.).

<sup>132</sup>*Ibid.*, at p. 73.

<sup>133</sup>One of the members of the Commission, the Honourable G. A. Gale, would go further and would impose upon an owner of goods a duty of reasonable care in respect of their security.

<sup>134</sup>See, for example, *Central Newbury Car Auctions Ltd. v. Unity Finance Ltd.*, footnote 130 *supra*; and, compare *People's Bank of Halifax v. Estey* (1904), 34 S.C.R. 429. See, further, Fridman, *Sale of Goods in Canada* (1973), pp. 117-22; and, *Benjamin's Sale of Goods* (1974), paras. 464-73.

<sup>135</sup>See, for example, *Foster v. Mackinnon* (1869), L.R. 4 C.P. 704; *Young v. Grote* (1827), 4 Bing. 253, 130 E.R. 764 (C.P.); *London Joint Stock Bank Ltd. v. Macmillan*, [1918] A.C. 777 (H.L.); *Wilson and Meeson (a Firm) v. Pickering*, [1946] K.B. 422 (C.A.), at p. 425.

<sup>136</sup>[1965] 2 Q.B. 242 (C.A.); *Benjamin's Sale of Goods* (1974), paras. 470-71.

<sup>137</sup>[1971] A.C. 1004 (H.L.).

<sup>138</sup>Compare, *Saunders v. Anglia Building Society*, footnote 137 *supra*, per Lord Wilberforce at p. 1026.

much less radical proposition to preclude an owner from recovering a chattel, or its value, in the hands of an innocent purchaser, when he has been responsible for his own loss. Of course, the law should be even-handed. The purchaser, as well as the owner, should be subject to a duty of care, but with this difference: the onus of showing his own care and good faith and of proving the owner's negligence should rest on the purchaser. Members of the Commission are equally divided<sup>139</sup> on the question whether, where both the owner and the purchaser have failed to exercise reasonable care, the court should be empowered to allocate the loss between them, and to make such other order with respect to the goods as is fair in the circumstances. Accordingly, although the Draft Bill contains a provision<sup>140</sup> permitting the court to allocate the loss, we make no recommendation concerning the desirability of its adoption in the revised Act.

What causes us concern is the potential encouragement to litigation, and the difficult factual and legal issues that may require resolution, where goods have passed through a succession of hands. It was these apprehensions that persuaded the Law Reform Committee<sup>141</sup> to reject Devlin, L.J.'s suggestion. While not wishing to ignore these difficulties, it may be that the Committee has unduly magnified them. Complex litigation involving questions of title is not unknown under the existing rules, and it seems unlikely that a defendant who has acquired converted goods will embark lightly upon an expensive defence unless he has a strong case. The double onus of proof that he will be called upon to discharge, coupled with the court's traditionally favoured disposition towards dispossessed owners, will act as additional deterrents.

Accordingly we recommend that the exception to the *nemo dat* doctrine now recognized in section 22 of *The Sale of Goods Act* in the case of conduct by the owner of goods precluding him from denying the authority of the person in possession to sell the goods, should be broadened to include cases where the owner has failed to exercise reasonable care in the entrustment of the goods,<sup>142</sup> and the buyer has exercised reasonable care in buying the goods and has acted in good faith.<sup>143</sup>

(d) ENTRUSTMENT OF GOODS TO A MERCHANT, OR ADOPTION OF A GENERAL MARKET OVERT RULE WITH RESPECT TO SALES MADE AT RETAIL PREMISES

We have previously expressed our support for a mercantile principle of *possession vaut titre* couched in language along the lines of UCC 2-403 (2).<sup>144</sup> It would involve some extension of the existing law, but not, we think, a very serious one.

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<sup>139</sup>The Honourable G. A. Gale, Mr. W. Gibson Gray, and the Honourable J. C. McRuer are opposed to such a provision.

<sup>140</sup>See, Draft Bill, s. 6.4(3).

<sup>141</sup>*Supra*, footnote 20, paras. 9 *et seq.*

<sup>142</sup>See, *supra*, footnote 133.

<sup>143</sup>See, Draft Bill, s. 6.4(2).

<sup>144</sup>*Supra*, this chapter, sec. 2(c).

The English Law Reform Committee apparently accepted the same principle as part of its wider proposal concerning sales at retail premises, but with one important restriction. A majority of the Committee recommended<sup>145</sup> that section 22(1) of the U.K. *Sale of Goods Act*<sup>146</sup> should be replaced by a provision to the effect that a person who buys goods by retail at trade premises or by public auction acquires a good title, provided he buys in good faith and without notice of any defect or want of title on the part of the apparent owner. The Committee recommended that "trade premises" should be defined<sup>147</sup> as "premises open to the public at which goods of the same or a similar description to those sold are normally offered for sale by retail in the course of business carried on at those premises". It would therefore appear that a wide range of commercial transactions would be excluded from the Committee's recommendation. The Committee offered no reason for excluding such transactions, other than the common law concept of "market overt". In our view, the proposal of the Committee restricting protection to those who purchase at retail premises would create a new set of anomalies. We do not, therefore, favour this approach. Accordingly, we recommend<sup>148</sup> that the revised Act contain an additional exception to the *nemo dat* rule, along the lines of UCC 2-403(2) and (3), in the case of entrustment of goods to a merchant. Our Draft Bill so provides.<sup>149</sup> In light of this recommendation it will be necessary, as mentioned earlier,<sup>150</sup> to review *The Factors Act* with a view to determining the desirability of its retention. We so recommend.

A second aspect of the recommendation of the English Law Reform Committee concerns the sale of lost or stolen goods. As will have been noted, UCC 2-403(2) is based on a concept of entrustment, not on a principle of *market overt*, and therefore does not apply where the goods sold by the merchant are stolen from, or lost by, the owner. On the other hand, the recommendation of the Law Reform Committee to extend the concept of *market overt* to sales at retail premises would include the sale of lost or stolen goods. The civil law jurisdictions that have adopted the *possession vaut titre* principle are divided on this issue.<sup>151</sup> Apparently only Italy fully protects the bona fide purchaser against the owner's claim. France and Quebec and other Civil Code systems that follow the Na-

<sup>145</sup>*Supra*, footnote 20, para. 33.

<sup>146</sup>Section 22 reads as follows:

(1) Where goods are sold in market overt, according to the usage of the market, the buyer acquires a good title to the goods, provided he buys them in good faith and without notice of any defect or want of title on the part of the seller.

(2) Repealed.

(3) The provisions of this section do not apply to Scotland.

As previously noted, the doctrine of *market overt* does not obtain in Ontario.

<sup>147</sup>*Supra*, footnote 20, p. 14, para. 33.

<sup>148</sup>As indicated, the Honourable J. C. McRuer dissents from this recommendation.

See, *supra*, this ch., footnote 91.

<sup>149</sup>See, Draft Bill, s. 6.7.

<sup>150</sup>*Supra*, this ch., sec. 2(c).

<sup>151</sup>Discussion of these divisions may be found in Sauveplanne, footnote 114 *supra*; Committee of Governmental Experts to Examine the Draft on the Protection of the Bona Fide Purchaser; Report by the Secretariat of UNIDROIT on the 3rd Session (July, 1974), Study XLV, Doc. 56.

poleonic model entitle the owner to recover the goods in the hands of a *bona fide* purchaser; but the owner is obliged to reimburse the purchaser the price he paid for the goods, if the purchaser bought the goods from a merchant acting in ordinary course, or in a similar commercial context. The status of stolen goods attracted intensive discussion among the Committee of Experts considering the draft Uniform International Law on the Protection of the *Bona Fide* Purchaser.<sup>152</sup> The original draft made no exception to the *possession vaut titre* principle for stolen goods. The June 1974 version reversed the position; a majority of the delegates were apprehensive that an unqualified principle might encourage trafficking in stolen goods, particularly works of art. As a result, Article II of the final text provides that the "transferee of stolen movables cannot invoke his good faith".

Given the divided voices within the civilian world, it is a little surprising that the English Law Reform Committee should have voted in favour of extending its modernized *market overt* concept to stolen goods.<sup>153</sup> It seems to us to be difficult to justify the proposal, and it is open to a large number of objections.<sup>154</sup> Ontario has never adopted the *market overt* principle, even in its restricted common law form, and it would be anomalous if the Province were now to embrace it on a much more extended basis. We do not, therefore, recommend adoption of the Committee's proposal.

#### (e) RESIDUAL QUESTIONS

We consider three such questions. The first question deals with recovery of goods by their owner upon reimbursement of the purchaser. The second question is concerned with the categories of person who should be protected by the entrustment provision in the revised Act and the provision comparable to section 25. The third question concerns the effect of revocation of consent by the owner of goods to possession of the goods by a buyer or seller in possession or by a merchant to whom the goods have been entrusted.

The first question may be phrased in this way. Assume that an owner has been deprived of title to his goods because of one of the exceptions to the *nemo dat* rule. Should he be entitled to recover the goods upon reimbursing the third party the price or other consideration given for the goods? As has been noted,<sup>155</sup> such a principle is recognized in

<sup>152</sup>Committee of Governmental Experts, *supra*, at pp. 16 *et seq.*

<sup>153</sup>Lord Donovan strongly dissented from the majority recommendation on the ground that it would encourage trafficking in stolen goods: see, *supra*, footnote 20, at pp. 18-19.

<sup>154</sup>No convincing need has been shown for such a broad rule. Further, it is possible that such a rule might encourage receipt of stolen goods. Moreover, while appropriate to an era when merchants moved about the country, the rule is questionable now that merchants have permanent places of business. See Hahlo, *Memorandum for Civil Code Revision Office*, Quebec, (21 July 1972), at pp. 13-15 and 26-29. (We are indebted to Professor P.-A. Cr  peau, Chairman of the Office, for giving us access to the memorandum and for permitting us to refer to it.)

<sup>155</sup>*Supra*, text to footnotes 114-116.

French and Quebec law in the case of lost or stolen goods acquired in a commercial sale. Several members of the Research Team have argued in favour of incorporating a similar principle in the revised Ontario Act, but on an enlarged basis. The argument put to us has been that an owner may have a particular attachment to an article, and that the third party will not ordinarily be prejudiced by being required to surrender the goods, so long as his reliance interests are protected.

Once again, what may appear to be a simple proposition is considerably complicated by several factors. First, the goods may have passed through a number of hands. Secondly, the goods may have been altered or improved since leaving the owner's hands. While we have concluded that a right of recovery should be recognized, and so recommend,<sup>156</sup> we are of the view that, in light of the above-mentioned factors, the right of recovery should be subject to the following qualifications.<sup>157</sup> The right of recovery should not apply where the owner originally entrusted the goods to a merchant who sold them in the ordinary course of his business. It should only apply where the court considers it fair to make such an order. Further, the terms of the order should be in the court's discretion, but in making such an order no account should be taken of any expectation losses suffered by the third person in whose hands the goods are located.

The second question that needs to be considered concerns the categories of person who should be protected by the proposed provisions. Here, too, there is much room for differences of opinion. As previously noted,<sup>158</sup> section 25 of *The Sale of Goods Act* extends to a "sale, pledge or other disposition" of the goods by the buyer or seller in possession. The Code adopts a different position. A person with a voidable title has power to transfer a good title to a "good faith purchaser for value". The words "purchaser", "purchase" and "value" are widely defined in UCC 1-201,<sup>159</sup> and include a taking by sale, pledge or lien and "any other voluntary transaction creating an interest in property".<sup>160</sup> A merchant, on the other hand, to whom goods have been entrusted within the meaning of UCC 2-403(2), can only transfer a better title than he himself has to "a buyer in ordinary course of business". This expression is also defined in the Code,<sup>161</sup> and appears to mean precisely what it says. The provision does not embrace a pledgee or other type of lienholder.<sup>162</sup> The supporting theory is, presumably, grounded on either of the following premises: namely, that commerce will not be impeded if lenders are required to

<sup>156</sup>See, Draft Bill, s. 6.9.

<sup>157</sup>Mr. McRuer's views are expressed in footnote 91, *supra*.

<sup>158</sup>*Supra*, this chapter, section 2(b)(5).

<sup>159</sup>See, UCC 1-201 (32), (33) and (44).

<sup>160</sup>This accords with the common law position, and follows from the premise that the transferor has title, albeit a voidable title.

<sup>161</sup>UCC 1-201(9).

<sup>162</sup>Note carefully, however, that UCC 2-403(2), unlike section 25 of *The Sale of Goods Act* or section 2 of *The Factors Act*, does not include dealings in documents of title. These are governed by Article 7 which, in the case of due negotiation of a negotiable document of title, confers very broad protection on the holder: see UCC 7-502.

assume the risk of a merchant-borrower exceeding his actual authority; or, that lenders are in as good a position as are entrusters, or perhaps even better, to protect themselves against a dishonest merchant.

We are attracted by this distinction and recommend that the persons to be protected in the revised Act, both for the purpose of the provision similar to section 25, and for the purpose of the entrustment provision, should be confined to buyers or lessees of the goods from the person in possession of them.<sup>163</sup> We would include lessees, both because of the importance and frequency of leasing transactions in the economy of Ontario, and because, in our view, a lessee deserves protection as much as a buyer. We recognize that lenders can be misled as much as buyers or lessees by a false appearance of ownership. But, in our view, this is not sufficient justification for extending to them the protection of the recommended exceptions to the *nemo dat* rule. There would have to be some evidence that economic efficiency, or superior ability to absorb this type of loss, militates in favour of shifting the burden to the owner of the goods. In our opinion, this aspect of the *nemo dat* doctrine requires further investigation. We would, however, emphasize that the foregoing restrictions should not apply to lenders and other persons who are holders of negotiable documents of title. They should be as fully protected as any other transferee for value.

The third question deals with the situation where an owner of goods revokes his consent to possession of the goods by a seller or buyer in possession or by a merchant to whom the goods have been entrusted. We have earlier recommended that a purported avoidance of a voidable contract of sale should not affect the position of a third party who purchases the goods in good faith from a person in possession, unless the goods are recovered by the owner before they have been delivered by the person in possession to the third party. We have also indicated our support for the equivalent principle enshrined in section 2(2) of *The Factors Act* and applied by the English Court of Appeal in *Newtons of Wembley v. Williams*.<sup>164</sup> We are of the view that this principle should be equally applicable to cases where goods have been entrusted to a merchant, or are held by a buyer or seller in possession. Accordingly, we recommend that, unless the goods are recovered by the owner before they have been delivered by the person in possession to the third party, the provisions of our recommended entrustment section and of the section in the revised Act comparable to section 25 of the existing Act should apply, even though the owner of the goods has revoked his consent to their possession by the merchant or seller or buyer, as the case may be.<sup>165</sup>

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<sup>163</sup>If the distinction is adopted in the revised Act, then further thought needs to be given to whether it should also be extended to those claiming the goods from a person with a voidable title to them. While legal theory is opposed to drawing a distinction in such a case between different types of transferees for value, functionally it is difficult to justify treating such persons more favourably than those acquiring an interest from a seller, buyer or merchant to whom the goods have been entrusted in the Code sense.

<sup>164</sup>[1965] 1 Q.B. 560 (C.A.).

<sup>165</sup>See, Draft Bill, s. 6.8(b).

### RECOMMENDATIONS

The Commission makes the following recommendations:

1. The revised Sale of Goods Act should not adopt a general *possession vaut titre* principle. Rather, the basic *nemo dat* doctrine should be affirmed.
2. The exceptions to the *nemo dat* doctrine contained in sections 22, 24 and 25 of the existing Sale of Goods Act should be retained in the revised Act, subject to the amendments and modifications set out below.
- \*3. The *nemo dat* rule should not apply in the circumstances set out in section 22 of the existing Act. However, the exception to the rule now recognized in the case of conduct by the owner precluding him from denying the authority of the person in possession to sell the goods should be broadened to include cases where the owner has failed to exercise reasonable care in the entrustment of the goods and the buyer has exercised reasonable care in buying the goods and has acted in good faith.
4. As under section 24 of the existing Act, a seller who has a voidable title to goods should be able to pass good title to a person who buys in good faith and without notice of the seller's defective title. For purposes of this exception to the *nemo dat* rule, the distinction between void and voidable titles should be abolished. The revised Act should, accordingly, contain a provision stating that a purchaser of goods shall be deemed to have a voidable title notwithstanding that the transferor of the goods was deceived as to the identity of the purchaser or the presence of some other mistake affecting the validity of the contract of sale, and also in circumstances similar to those set out in UCC 2-403(1) (b), (c) and (d).
5. The revised Act should provide that, where the seller has or is deemed to have a voidable title, a purported avoidance of the contract by the owner of the goods shall have no effect on a third party, unless the goods are recovered by the owner before they are delivered to the third party by the person in possession of the goods.
6. Subject to the following amendments, the revised Act should contain a provision comparable to section 25 of the existing Sale of Goods Act, which recognizes an exception to the *nemo dat* rule in the case of a transfer of goods, or of a document of title, by buyers and sellers in possession:
  - (a) The power of a seller in possession to transfer a better title to goods than he himself has should apply whether he is, or continues, in possession of the goods in his capacity as seller, or otherwise.

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\*One of the Commissioners, the Honourable G. A. Gale, would extend this recommendation. See, footnote 133, *supra*.

- (b) The power of a buyer or seller in possession to transfer a better title than he himself has shall not apply where a security interest governed by *The Personal Property Security Act* has been created in the seller or buyer out of possession, or where, prior to the disposition to the third party, a notice in the prescribed form has been filed under *The Personal Property Security Act*.
  - (c) The power of a buyer or seller in possession to pass a better title to a third person than he himself has shall be contingent upon his originally being in possession of the goods, or of a document of title thereto, with the consent of the other party to the transaction; and in all other respects, the conditions governing the dispositive powers of buyers and sellers in possession should be the same.
  - (d) The protection of the provision in the revised Act comparable to section 25 should be confined to a buyer or lessee who receives the goods in good faith and for value from the person in possession.
  - (e) The scope of the provision in the revised Act comparable to section 25 should be enlarged to cover a prospective buyer, as well as an actual buyer, in possession of the goods. A prospective buyer should be defined to mean a person who receives goods under a sale on approval or contract of sale or return or with an option to purchase, and a person whose offer to buy the goods has been accepted subject to the approval of a third person or the fulfilment of some other condition.
7. The revised Act should not incorporate a general *market overt* rule with respect to sales, including sales of lost or stolen goods, made at retail premises.
  - \*\*8. The revised Act should contain a further exception to the *nemo dat* doctrine, along the lines of UCC 2-403(2), in the case of goods entrusted to a merchant who deals in goods of the kind entrusted. Any entrusting of possession of goods to a merchant who deals in goods of that kind should give him power to transfer all rights of the entruster to a buyer or lessee in the ordinary course of business. "Entrusting" should be defined in the revised Act as in UCC 2-403(3).
  9. In light of recommendation No. 8, *supra*, *The Factors Act* should be reviewed with a view to determining the desirability of its retention.
  10. The ability of a buyer or seller in possession, or of a merchant to whom goods have been entrusted, to pass better title than he himself has should apply even though the owner has revoked his

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\*\*The Honourable J. C. McRuer dissents from the recommendation. See, footnote 91, *supra*.

consent to possession of the goods by the other party, unless the goods are recovered by the owner before they have been delivered to the third party.

- \*\*\*11. Except in the case of entrustment of goods to a merchant who deals in goods of that kind, the court should be able, where it considers it fair, to order that the owner of goods may recover the goods from the person in possession upon repaying to the person in possession the price paid by the person in possession for the goods, together with such reliance losses as the person in possession would otherwise suffer and as the court may order to be paid.

12. *The Bills of Sale Act* should be repealed.

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\*\*\*The Honourable J. C. McRuer dissents in part from this recommendation. See, footnote 91, *supra*.

## CHAPTER 13

### DOCUMENTS OF TITLE

#### 1. THE NEED FOR COMPREHENSIVE CODIFICATION

A document of title, as commonly understood in the sales context, is a writing, generally issued by a person in the business of warehousing or transporting goods, purporting to cover goods in his possession, and entitling the holder of the writing to deal with the goods.<sup>1</sup> There are two kinds of documents of title: (1) a bill of lading, being an acknowledgment by a carrier that the goods have been received for carriage; and (2) a warehouse receipt, being an acknowledgment by a bailee that goods have been received for storage. Documents of title are comparable to bills of exchange, notes and cheques in that, in the ordinary course of commerce, the rights represented by the document can be transferred by transferring possession of the document itself, with any necessary endorsement. They are also similar in that a bill, note or cheque represents the right to receive payment, while a document of title represents the right to receive possession of goods. However, the comparison is not exact. The incidents attached to bills, notes and cheques are clearly established as a result of comprehensive federal legislation, while the incidents attached to documents of title are less clear. Moreover, both at common law and under the relevant statutes, there are important differences in these incidents.

We have not undertaken an exhaustive examination of the law relating to documents of title, but their role cannot be ignored. They are mentioned in several sections of the existing Sale of Goods Act<sup>2</sup> and affect some basic issues of sales law. These issues include the effect of documents of title on the following: (1) the passing of title and risk between seller and buyer; (2) the seller's delivery obligations; (3) the seller's remedies; and, (4) the operation of the *nemo dat* rule and the statutory protection given to innocent third parties. In examining these issues we have encountered two basic difficulties with the existing law. The first difficulty is the lack of codification of the law relating to documents of title in Ontario. The second difficulty concerns the nature of the legislative changes that have been made to the common law.

As to the first difficulty, there is, as stated, no modern comprehensive codification of the law relating to documents of title in Ontario.<sup>3</sup> Nor are documents of title governed by a clear body of common law. We are told by Falconbridge that, by the late nineteenth century, bills of lading were instruments well known to commerce and that, by the custom of

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<sup>1</sup>For a general discussion of this topic, see, Marvin Baer, "Documents of Title", Research Paper No. IV.3.

<sup>2</sup>See, ss. 1(1)(e), 20(2), 20(3), 25(1), 25(2), 28(3), 37(2), and 45.

<sup>3</sup>Many aspects of the law relating to warehouse receipts, however, are covered by *The Warehouse Receipts Act*, R.S.O. 1970, c. 489.

merchants, peculiar incidents were attached to them. Peculiar incidents were not, on the other hand, attached by custom to warehouse receipts.<sup>4</sup> There are few modern Canadian cases dealing with the law relating to documents of title, and some of the older cases are inconsistent with the assumptions underlying modern usage of these documents.<sup>5</sup>

This point can be illustrated by examining a distinction commonly made in modern commercial practice. Borrowing ideas and nomenclature from other branches of negotiable instrument law, and perhaps relying upon American precedents, it is common in practice to distinguish between negotiable and non-negotiable documents of title. This distinction may center, according to trade usage, on one or more of a number of things. First, it may go to the issue of whether the document is transferable at all. Secondly, the distinction may relate to the form of the transfer; that is, whether the bailee must acknowledge or attorn to the transferee before the transferee has any right under the document. Thirdly, the distinction between negotiable and non-negotiable documents of title may determine whether the document is intended to be assignable free from the equities existing between the original parties; that is, whether the bailee can raise any claim or defense that he had against the original holder against a subsequent holder of the document. Fourthly, the distinction may be relevant in determining whether a transferee of an apparently regular document, who takes in good faith for value and without notice of a defect in the title of his transferor, or of the want of title of his transferor, takes free from that defect or want of title.

In contexts other than documents of title, it is primarily the fourth meaning that is the essence of negotiability.<sup>6</sup> Yet at common law, according to Falconbridge,<sup>7</sup>

A bill of lading, and *a fortiori* any other document of title to goods, is not negotiable in the same sense as a bill of exchange may be negotiable, and therefore the mere honest *possession* of a bill of lading endorsed in blank, or in which the goods are made deliverable to the bearer, is not such a title to the goods as the like possession of a bill of exchange would be to the money promised to be paid by the acceptor. The endorsement of a bill of lading gives no better right to the goods than the endorser himself had . . . .

By *The Warehouse Receipts Act*,<sup>8</sup> negotiable warehouse receipts are given incidents of negotiability similar to those attached to bills and notes.

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<sup>4</sup>Falconbridge, *Banking and Bills of Exchange* (7th ed., 1969), 215.

<sup>5</sup>For example, according to some older Canadian cases the transfer of a warehouse receipt did not pass to the transferee the property in the goods. See, *Bank of British North America v. Clarkson* (1869), 19 U.C.C.P. 182, 188.

<sup>6</sup>Falconbridge, footnote 4 *supra*, at p. 409.

<sup>7</sup>*Ibid.*, at p. 203.

<sup>8</sup>R.S.O. 1970, c. 489, ss. 22, 23, 26.

However, there is no federal or provincial legislation that does the same for bills of lading.<sup>9</sup>

Since the documents themselves seldom set out what is meant by "negotiable" or "non-negotiable", the parties are left, in the event of a dispute, to establish the meaning of these terms by trade usage. This they must do against a background of common law rules, which have developed little since the last century and which seem flatly to contradict the parties' assumptions.

The second basic difficulty with the existing law governing documents of title is the nature of the legislative changes that have been made to the common law. There are references to documents of title scattered throughout several Ontario statutes, including *The Sale of Goods Act*, *The Factors Act*,<sup>10</sup> *The Personal Property Security Act*,<sup>11</sup> *The Mercantile Law Amendment Act*<sup>12</sup> and *The Warehouse Receipts Act*.<sup>13</sup> In addition, there is federal legislation covering some aspects of bills of lading, such as the *Bills of Lading Act*<sup>14</sup> and the regulations made pursuant to the *Railway Act*.<sup>15</sup> The provincial legislation is marked by significant inconsistencies, much duplication and numerous gaps. The inconsistencies include such a basic matter as the lack of a uniform definition of documents of title.<sup>16</sup> Further, these inconsistencies extend to the radically different treatment accorded to warehouse receipts and bills of lading: the former are covered by fairly comprehensive legislation, while the latter are governed by the common law. The duplication in provincial legislation centers on the overlapping protection given to innocent holders of documents of title.<sup>17</sup> They are protected by provisions in four acts: namely, *The Sale of Goods Act*, *The Factors Act*, *The Mercantile Law Amendment Act* and *The Warehouse Receipts Act*. These acts do not, however, adopt any consistent theory as to the circumstances in which innocent holders should be protected from defects of title. The gaps in provincial legislation relate primarily to bills of lading, rather than to warehouse receipts. They include such basic matters as the formal requirements of a document of title, the obligations of a bailee who holds goods under a document of title, the extent of the

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<sup>9</sup>See, however, General Order No. T-5 of the Revised General Orders of the Board of Transport Commissioners for Canada, 1965, S.O.R. 72-625, made pursuant to the *Railway Act*, R.S.C. 1970, c. R-2. General Order No. T-5 distinguishes between "straight" and "order" bills of lading. In addition, General Order No. T-6 approves the use of the Uniform Bill of Lading in use in the United States for shipments between Canada and the United States. General Order No. T-5 has not been construed as extending the incidents of negotiability at common law in the case of order bills of lading, or as conferring upon them true negotiability. See, *C.P.R. v. Hickman Grain Co.*, [1928] S.C.R. 170, [1928] 1 D.L.R. 1069 (S.C.C.), especially at [1928] S.C.R. 175, [1928] 1 D.L.R. 1071; and [1927] 1 D.L.R. 851 (Man. C.A.), at pp. 862-63.

<sup>10</sup>R.S.O. 1970, c. 156.

<sup>11</sup>R.S.O. 1970, c. 344 as am.

<sup>12</sup>R.S.O. 1970, c. 272.

<sup>13</sup>R.S.O. 1970, c. 489.

<sup>14</sup>R.S.C. 1970, c. B-6.

<sup>15</sup>*Supra*, footnote 9.

<sup>16</sup>See, Baer, footnote 1 *supra*, at pp. 1-4.

<sup>17</sup>*Ibid.*, at pp. 21-32.

bailee's lien, and the form and effect of negotiation or transfer of these instruments.

These shortcomings in existing Ontario law appear to us to be unacceptable. We accordingly recommend a comprehensive examination of the law relating to documents of title with a view to its systematic codification. A model for such a systematic treatment of documents of title already exists in Article 7 of the *Uniform Commercial Code*, and we recommend the examination of Article 7 with a view to determining its suitability for adoption in Ontario.

In the meantime, we do not think it possible or wise to omit all references to documents of title in the revised Sale of Goods Act. The provisions necessary to take into account the existence of a document of title are discussed or referred to in appropriate chapters of this Report. In these chapters we do not focus on documents of title, although the basic issues of sales law affected by the existence of a document of title are comprehended by the recommendations made therein. These basic issues are discussed more fully below. The purpose of the following discussion is not, however, to put forward additional recommendations. Rather, it is intended to confirm the recommendations made in other contexts as they relate to documents of title, in order to enable the reader to obtain a more global view of the impact of documents of title on sales law.

While recognizing the need for more comprehensive reform, our basic approach in dealing with documents of title under the revised Act has been to preserve the existing law that, in relation to several matters, documents can take the place of or represent goods.<sup>18</sup> In some cases we have, however, distinguished between negotiable and non-negotiable documents, even though this is a distinction that has no clear meaning at common law, and even though Ontario lacks a comprehensive statutory treatment of this distinction. We have done this because the distinction is widely used in commercial practice, and is also found in *The Personal Property Security Act*. In the absence of comprehensive legislation, such as Article 7 of the *Uniform Commercial Code*, the full range of incidents associated with negotiable and non-negotiable documents will have to be established by trade usage. Finally, some recommended changes are simply consequential amendments which result from our earlier recommendations to separate the issues of risk of loss from the passing of property.

Before turning to our discussion of the basic issues in the sales context affected by the existence of a document of title, we deal with the definition of "document of title" recommended for adoption in the revised Act.

## 2. DEFINITION OF "DOCUMENT OF TITLE"

Section 1(1)(e) of *The Sale of Goods Act* defines document of title as follows:

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<sup>18</sup>For example, in accordance with recommendations made in chapters 11 and 12, respectively, property and risk may pass with the transfer of a document, and the receipt of a document by an innocent third party may be the equivalent of the receipt of the goods.

'document of title' includes a bill of lading and warehouse receipt as defined by *The Mercantile Law Amendment Act*, any warrant or order for the delivery of goods and any other document used in the ordinary course of business as proof of the possession or control of goods or authorizing or purporting to authorize, either by endorsement or delivery, the possessor of the document to transfer or receive goods thereby represented;

A modernized, but substantially similar, definition appears in section 1(i) of *The Personal Property Security Act*, and reads as follows:

'document of title' means any writing that purports to be issued by or addressed to a bailee and purports to cover such goods in the bailee's possession as are identified or fungible portions of an identified mass, and that in the ordinary course of business is treated as establishing that the person in possession of it is entitled to receive, hold and dispose of the document and the goods it covers;

This definition is essentially based on UCC 1-201(15), and differs from the definition in *The Sale of Goods Act* in two important respects: (a) it omits any reference to the definition of warehouse receipts in *The Mercantile Law Amendment Act*; and, (b) it emphasizes the fact, not mentioned in *The Sale of Goods Act* definition, that the writing must be issued by or addressed to a bailee of the goods. It is our view that consistency with the definition in *The Personal Property Security Act* is desirable. Subject to a minor amendment mentioned below, we recommend adoption of this definition in the revised Sale of Goods Act. Apart from the benefits of consistency, we have several other reasons for our recommendation. First, the reference in section 1(1)(e) of the present Act to the definition of warehouse receipts in *The Mercantile Law Amendment Act* is no longer helpful, given the substantially obsolete character of the provisions in question in the latter Act. Secondly, there is a close relationship in practice between sales transactions and secured transactions, and both *The Personal Property Security Act* and many of the provisions in the proposed revised Act have common roots in the *Uniform Commercial Code*. Thirdly, a new definition will provide the foundation for a document of title law, if such a law should be adopted in the future.

We recommend one small amendment to the definition in *The Personal Property Security Act*: namely, the insertion of the words "with any necessary endorsement" after the words "the person in possession . . . is". The purpose of the amendment is to avoid any implication that the definition is restricted to a bearer document. As a result, our recommended definition reads as follows:<sup>19</sup>

'document of title' means a writing that,

- (i) purports to be issued by or addressed to a bailee,
- (ii) purports to cover goods in the bailee's possession that are identified or fungible portions of an identified mass, and
- (iii) in the ordinary course of business is treated as establishing that

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<sup>19</sup>See, Draft Bill, s. 1.1(1)11.

the person in possession of the document of title is, with any necessary endorsement, entitled to receive, hold and dispose of it and the goods it covers;

### 3. BASIC ISSUES IN THE SALES CONTEXT

#### (a) THE PASSING OF PROPERTY

We have discussed in chapter 11 the relevance of title or property to the rights and obligations of parties to a contract of sale. In that chapter, we also dealt with residual title rules for situations not specifically covered in the revised Act. It is in this latter context that we discuss the effect of a transfer of a document of title on the passing of property in the goods.

In discussing when the property in goods covered by a document of title passes at common law between seller and buyer, it is necessary to distinguish between contracts that require or authorize the seller to send the goods to the buyer, and contracts that provide for delivery without movement of the goods. In the former case, the relevant document will be a bill of lading; in the latter case, the relevant document will be a warehouse receipt.

It is often said that a document of title such as a bill of lading is universally recognized as a symbol for the goods, and that an endorsement and delivery of the bill of lading operates as a symbolic delivery of the goods. However, at common law, the endorsement of a bill of lading did not, of itself, transfer the property in the goods in the same way that the endorsement and delivery of a bill of exchange transfers the property in the subject matter of the bill of exchange. An endorsement and delivery of a bill of lading only transferred such title as was intended to be transferred.<sup>20</sup> Subsequent statutes, including *The Sale of Goods Act*, did not change this common law rule. However, the courts, in applying section 19, Rule 5(ii) and section 20 of *The Sale of Goods Act* to contracts using trade terms that contemplate the creation of bills of lading, often associated the passing of property with the endorsement and delivery of a bill of lading.<sup>21</sup> In this context, however, the courts have occasionally departed from their usual tendency to treat property in goods as an indivisible concept, and have discovered an intention to reserve some interest to the seller while at the same time passing general property to the buyer.<sup>22</sup>

On the other hand, in relation to warehouse receipts, the position is

<sup>20</sup>*Lickbarrow v. Mason* (1787), 2 T.R. 63, 100 E.R. 35 (K.B.); *Sewell v. Burdick* (1884), 10 App. Cas. 74 (H.L.). See, also, *Scrutton on Charterparties* (17th ed., 1966), at p. 168; and Falconbridge, *Banking and Bills of Exchange* (7th ed., 1969), at p. 199.

<sup>21</sup>See, generally, Sassoon, *C.I.F. and F.O.B. Contracts* (2nd ed., 1975); and Crawford, "Performance Obligations: Delivery and Payment", Research Paper No. III.6, at pp. 42-46, 52-53.

<sup>22</sup>See, for example, *Mirabita v. Imperial Ottoman Bank* (1878), 3 Ex. D. 165 (C.A.), *per* Bramwell, L.J., at pp. 169-70; and *Jenkyne v. Brown* (1849), 14 Q.B. 496. In Canada, see *Bergert v. Parry* (1922), 70 D.L.R. 233 (Alta. S.C., App. Div.); and *Jerome v. Clements Motor Sales Ltd.*, [1958] O.R. 738, (1959), 15 D.L.R. (2d) 689 (C.A.). See, also, *infra*, ch. 14, sec. A.3(c).

different. The common law has been significantly changed by *The Warehouse Receipts Act*. Sections 21 and 22 of that Act pass title to the goods by the transfer or due negotiation of the warehouse receipt.

The provisions of UCC 2-401(2) and (3), which deal with the residual rules governing transfer of title, reach much the same result as the existing Ontario law. Under the Code provisions, a distinction is made between contracts that require or authorize the seller to send the goods to the buyer, and contracts that provide for delivery without movement of the goods. In the first case, property passes when the seller has fulfilled his obligations as to shipment under the contract, even though a document of title is to be delivered at a different time or place. This rule is similar to the rule adopted in those Anglo-Canadian cases that recognizes that the issuance of a document in the seller's name only evidences an intention to reserve a security interest or special property, and does not prevent the passing of the general property in the goods.<sup>23</sup> In the second case, where there is to be delivery without movement of the goods, the Code, like *The Warehouse Receipts Act*, provides that title passes at the time and place of the delivery of the document.

In a previous chapter, we recommend the adoption, with modifications, of provisions similar to UCC 2-401(2) and (3).<sup>24</sup> In our view, these Code provisions, as they relate to documents of title, should be adopted in the revised Act in preference to the existing provisions of section 19, Rule 5(ii), of *The Sale of Goods Act*. The Code provisions are more comprehensive and the reference to documents of title more explicit.

#### (b) RISK OF LOSS

Ontario legislation contains no special provisions relating to risk of loss of goods covered by a document of title. Hence, the normal rule applies that risk passes with property. While the Code has relinquished the simple rule that risk attends title, the provisions of UCC 2-509 covering the risk of loss in the absence of breach, at least where goods are covered by documents of title, closely parallel those of UCC 2-401 covering the passing of title. Once again, there is a significant difference between the Code and existing Ontario law. This difference resides in the effect of the reservation of a right of disposal by the seller by having the document of title issued in his name or to his order. Under Ontario law, in the absence of contrary agreement between the parties (including any applicable mercantile terms) the reservation of a right of disposal will, by virtue of section 20(1) of *The Sale of Goods Act*, prevent the transfer of title to the buyer and also, therefore, the passing of risk. In the Code, on the other hand, the seller's reservation of title does not affect the rules on the transfer of risk and, moreover, UCC 2-505 makes it clear that the seller's reservation is only in the nature of a security interest.

We have previously recommended<sup>25</sup> that a provision similar to UCC

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<sup>23</sup>*Ibid.*

<sup>24</sup>*Supra*, ch. 11, Recommendations 13, 14.

<sup>25</sup>*Supra*, ch. 11, Recommendations 3 to 7.

2-509 dealing with transfer of risk of loss be adopted in the revised Act, subject to certain amendments and clarifications. In our view, the provisions of UCC 2-509 as they relate to documents of title should also be included in the revised Act. Our Draft Bill so provides.<sup>26</sup>

(c) DOCUMENTS OF TITLE AND THE SELLER'S DELIVERY OBLIGATIONS<sup>27</sup>

The existing Sale of Goods Act says little about the effect of the issuance of a document of title on the seller's obligation to deliver the goods. Two provisions of the Act merit reference. Cases in which a document of title has been issued are specifically excluded from the operation of section 28(3), which controls the time of delivery where goods are held by a bailee that are not to be shipped. Section 31(1) of *The Sale of Goods Act*, which deals with the effect of delivery to a carrier where the seller is authorized or required to send the goods to the buyer, does not specifically exclude from its operation cases where documents of title have been issued. The courts have, however, arrived at this result by emphasizing that section 31 is only a *prima facie* rule. We turn now to consider the situations contemplated by these provisions.

(i) *Goods Held by a Bailee That Are Not to be Shipped*

As noted, cases in which a document of title has been issued are expressly excluded from the operation of section 28(3) of *The Sale of Goods Act*. As a result, what constitutes an effective tender of delivery where goods are covered by a document of title is left to be resolved by the common law and other statutes. In Ontario, sections 21 and 22 of *The Warehouse Receipts Act* provide that a transferee of a warehouse receipt receives "the benefit of the obligation of the warehouseman to hold possession of the goods for him . . .". A similar, but more elaborate, rule is found in UCC 2-503(4).<sup>28</sup> This provision contains additional qualifications that clarify the circumstances in which failure by the bailee to honour a document of title will defeat the seller's tender. We think that the pro-

<sup>26</sup>See, Draft Bill, s. 7.8.

<sup>27</sup>The seller's delivery obligations are discussed more fully in chapter 14 of the Report.

<sup>28</sup>Section 2-503(4) provides as follows:

(4) Where goods are in the possession of a bailee and are to be delivered without being moved

(a) tender requires that the seller either tender a negotiable document of title covering such goods or procure acknowledgment by the bailee of the buyer's right to possession of the goods; but

(b) tender to the buyer of a non-negotiable document of title or of a written direction to the bailee to deliver is sufficient tender unless the buyer seasonably objects, and receipt by the bailee of notification of the buyer's rights fixes those rights as against the bailee and all third persons; but risk of loss of the goods and of any failure by the bailee to honor the non-negotiable document of title or to obey the direction remains on the seller until the buyer has had a reasonable time to present the document or direction, and a refusal by the bailee to honor the document or to obey the direction defeats the tender.

visions of UCC 2-503(4) as they relate to documents of title would be useful additions to our revised Act, and recommend their adoption in lieu of the provisions of section 28(3) of the existing Act. Our Draft Bill contains a provision giving effect to this recommendation.<sup>29</sup>

(ii) *Goods Authorized or Required to be Shipped*

The *prima facie* rule found in section 31(1) of the Ontario Sale of Goods Act, that delivery to the carrier is delivery to the buyer, may be displaced where the seller reserves a right of disposal in the goods.<sup>30</sup> Section 20(2) provides that, where the goods are shipped and by the bill of lading the goods are deliverable to the order of the seller or his agent, the seller is *prima facie* deemed to reserve the right of disposal. In this way a bill of lading may determine whether there has been delivery of the goods and, arguably, locate the place of the buyer's right of inspection, since delivery and the right of inspection are usually treated as coterminous events. In contrast, the Code has specific provisions for inspection in section 2-513, which are functionally oriented and divorced from questions of delivery. In addition, as indicated, section 2-505 has recognized that the reservation of a right of disposal has the limited purpose of giving the seller a security interest, and has no bearing on other issues. Finally, sections 2-503(2) and (3) and 2-504 set out more fully the seller's general duty of tender and delivery in shipment and destination contracts, including those involving documents of title. These provisions are examined in greater detail in chapter 14. We also explain elsewhere, in a more general context, the advantages of the Code's separate provision for inspection, and its limitation of the seller's right of disposal to a security interest.<sup>31</sup> The rationale that supports these provisions is equally applicable where documents of title are involved. Accordingly, we recommend that the revised Act should incorporate provisions similar to UCC 2-503(2) and (3) and UCC 2-504 with respect to the role of documents of title affecting the seller's delivery obligations in shipment and destination contracts. As under the *Uniform Commercial Code*, the revised Act should incorporate separate rules, unconnected with questions of delivery, with respect to the effect of the reservation of a right of disposal and the place of inspection of goods after delivery.<sup>32</sup>

(d) THE UNPAID SELLER'S RIGHT TO WITHHOLD AND STOP DELIVERY<sup>33</sup>

(i) *As Against the Buyer*

The existing Sale of Goods Act recognizes, in section 38, the unpaid

<sup>29</sup>See, Draft Bill, s. 7.2(4).

<sup>30</sup>Fridman, *Sale of Goods in Canada* (1973), at p. 256, n. 27; Greig, *Sale of Goods* (1974), at pp. 113-14 (Greig draws a distinction between f.o.b. and c.i.f. contracts). *Williston on Sales* (Rev. ed., 1948), secs. 468a-469, appears to adopt conflicting positions. The lack of consistency among authors and in the decisions probably arises from the attempt to force a single concept, "possession", to serve too many disparate purposes.

<sup>31</sup>See, chapters 14 and 17.

<sup>32</sup>See, Draft Bill, ss. 7.2, 7.3, 7.4 and 7.12.

<sup>33</sup>This matter is discussed in greater detail in chapter 16.

seller's right of lien over goods while they are in his possession, and his right to stop delivery of goods in transit where the buyer becomes insolvent. While *The Sale of Goods Act* contains detailed provisions<sup>34</sup> stipulating when the unpaid seller's lien and right to stop in transit are lost, there is no comprehensive provision applicable where the goods are covered by a document of title. This matter is covered more comprehensively, at least so far as the right to stop delivery is concerned, in UCC 2-705(2),<sup>35</sup> and is impliedly covered by the provisions in UCC 2-503 and 2-504 with respect to loss of the right of lien or retention. UCC 2-705(2) recognizes the modern commercial assumptions behind the use of negotiable documents of title, and is compatible with other Ontario legislation.<sup>36</sup> We recommend the adoption in the revised Act of an equivalent provision, so far as it relates to documents of title.<sup>37</sup>

### (ii) *As Against Third Parties*

Section 45 of the Ontario Sale of Goods Act states that the unpaid seller's right of lien or retention or stoppage in transit is not affected by any sale or other disposition of the goods that the buyer may have made. However, this section contains an express exception in the case of good faith transferees of documents of title. The protection given transferees of documents of title by this section is duplicated in a number of other Ontario Acts.<sup>38</sup> In light of the immediately preceding recommendation, such third parties will also be protected by the limitation on the right to withhold and stop delivery found in the provision of the revised Act equivalent to UCC 2-705(2).<sup>39</sup> Moreover, protection may be afforded by the more general qualifications to the *nemo dat* principle recommended in chapter 12.<sup>40</sup> The exception, then, to section 45 will be adequately covered in the revised Act. So far as the main proposition in section 45 is concerned — that is, that the unpaid seller's right of lien or retention or stoppage is not affected by the buyer's dealing with the property — it appears to be tautologous, since it simply reaffirms the rights given by section 38. Accordingly, we are of the view that section 45 can be safely omitted from the revised Act, and we so recommend.

### (e) TRANSFER OF TITLE AND GOOD FAITH BUYERS

At common law, the negotiation of a document of title gave the holder no better right to the goods than that possessed by his transferor. The common law rule has been modified in Ontario by several statutory provisions.<sup>41</sup> These provisions are confusing and overlapping, and consti-

<sup>34</sup>Sections 41, 42, 43.

<sup>35</sup>See, further, chapter 16, sec. 2(b)(ii).

<sup>36</sup>See, for example, *The Factors Act*, s. 2; *The Sale of Goods Act*, s. 25(1) and (2); *The Warehouse Receipts Act*, s. 27; and, *The Personal Property Security Act*, s. 31(1)(b).

<sup>37</sup>See, Draft Bill, s. 9.8(2).

<sup>38</sup>*The Factors Act*, s. 2; *The Mercantile Law Amendment Act*, ss. 8, 14; *The Personal Property Security Act*, s. 31(1)(b); *The Sale of Goods Act*, ss. 25(1) and (2), and 45; *The Warehouse Receipts Act*, ss. 21, 22, 27.

<sup>39</sup>See, Draft Bill, s. 9.8(2). See, also, s. 9.8(9).

<sup>40</sup>See, Draft Bill, ss. 6.6 to 6.8.

<sup>41</sup>*Supra*, footnote 38.

tute one of the reasons why we have recommended that Article 7 be examined for possible adoption in Ontario. In the meantime, as has been stated, we believe that holders of documents of title should continue to enjoy whatever protection they now enjoy under the law. We have previously discussed sections 25(1) and (2) of *The Sale of Goods Act*. These provisions protect transferees of documents of title in the same way as they protect transferees of goods. We recommend that the same protection be built into the new Act; that is, to the extent that innocent transferees of goods are protected, so should be the innocent transferees of documents of title.<sup>42</sup> At the same time, we recommend that they continue to enjoy whatever other protection is given to them by other statutes.<sup>43</sup>

### RECOMMENDATIONS

The Commission makes the following recommendations:

1. The Ontario law of documents of title should be comprehensively examined with a view to its systematic codification.
2. Article 7 of the *Uniform Commercial Code* would appear to provide an appropriate model for the systematic treatment of documents of title, and should be examined with a view to determining its suitability for adoption in Ontario.
3. Pending the conclusion of such a review, it is neither possible nor wise to omit all references to documents of title in the revised Sale of Goods Act; rather, the revised Act should incorporate provisions relating to documents of title in accordance with recommendations 4-11, *infra*.
4. Subject to a minor amendment, a definition of "document of title" similar to the definition of the term contained in section 1(i) of *The Personal Property Security Act* should be substituted in the revised Act for the definition contained in section 1(1)(e) of the existing Sale of Goods Act.
5. With respect to the residual rules governing the transfer of title, the provisions of UCC 2-401(2) and (3), as they relate to documents of title, should be adopted in the revised Act in preference to the provisions of section 19, Rule 5 (ii), of the existing Sale of Goods Act.
6. The provisions of UCC 2-509 governing the transfer of risk of loss in the absence of breach should be included in the revised Act, so far as they relate to documents of title.
7. With respect to the seller's delivery obligations where goods are held by a bailee and delivery is to be effected without shipment, the provisions of UCC 2-503(4) relating to documents of title should be adopted in the revised Act in lieu of the provisions of section 28(3) of the existing Sale of Goods Act.

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<sup>42</sup>See, Draft Bill, s. 6.2.

<sup>43</sup>See, Draft Bill, s. 3.4(2).

8. The revised Act should incorporate provisions similar to UCC 2-503(2) and (3) and UCC 2-504 with respect to the role of documents of title affecting the seller's delivery obligations in shipment and destination contracts. As under the *Uniform Commercial Code*, the revised Act should incorporate separate rules, unconnected with questions of delivery, with respect to the effect of the reservation of a right of disposal and the place of inspection of goods after delivery.
9. An unpaid seller's right to stop delivery of goods in transit as against the buyer should be governed in the revised Act by a provision similar to UCC 2-705(2), so far as it relates to documents of title.
10. Section 45 of the existing Sale of Goods Act is tautologous and should be omitted from the revised Act.
11. Pending the adoption of a comprehensive documents of title law, transferees of documents of title should enjoy the same protection afforded to transferees of goods under the provisions of the revised Act as recommended in chapter 12, *supra*, and without prejudice to their rights under any other Act.

## CHAPTER 14

### DELIVERY AND PAYMENT

#### A. DELIVERY

##### 1. INTRODUCTION

A number of preliminary observations are in order.<sup>1</sup> First, by virtue of sections 26 and 27 of the Ontario Sale of Goods Act, the seller's basic obligation to deliver the goods conditions his *prima facie* right to payment and acceptance by the buyer. However, delivery also has other important consequences, both under existing Anglo-Canadian law and even more so under Article 2 of the *Uniform Commercial Code*. Under *The Sale of Goods Act*, delivery affects the seller's lien rights<sup>2</sup> and the rights of third parties who deal in good faith with a buyer who has been entrusted with goods or with the documents of title thereto.<sup>3</sup> Further, in the case of a sale of future or unascertained goods,<sup>4</sup> delivery usually coincides with the transfer of title, and therefore determines the time for the transfer of risk.

These important consequences have not been diminished by the Code. Indeed, Article 2 has increased their number. It may, therefore, fairly be said that, while the role of title has been demoted under the Code, that of delivery has been enhanced. This is not surprising, since most buyers are more conscious of the need to obtain possession of the goods, than they are to ascertain the status of an abstraction; the seller's right to sell is usually taken for granted. All this leads to the conclusion that there is no difference in doctrinal approach with respect to problems of delivery between *The Sale of Goods Act* and Article 2. The difference lies in matters of detail, and in the greater particularization of rules and situations adopted in Article 2. There is a further point. The Article 2 rules differ from the Ontario provisions in that they are closely integrated with the other Articles of the Code on Documents of Title (Article 7) and Secured Transactions (Article 9). The Ontario seller, on the other hand, is confronted with a large variety of statutes, federal as well as provincial,<sup>5</sup> which are not necessarily consistent with one another or with the provisions of *The Sale of Goods Act*, and which need to be consulted for a full statement of his delivery obligations.

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<sup>1</sup>For a general discussion of the topic of delivery and payment, see Crawford, "Performance Obligations: Delivery and Payment", Research Paper No. III.6.

<sup>2</sup>*The Sale of Goods Act*, R.S.O. 1970, c. 421, ss. 38-39.

<sup>3</sup>*Ibid.*, ss. 25(2), 45.

<sup>4</sup>*Ibid.*, s. 19, Rule 5(ii).

<sup>5</sup>See, for example, *The Warehouse Receipts Act*, R.S.O. 1970, c. 489; *The Mercantile Law Amendment Act*, R.S.O. 1970, c. 272; the *Bills of Lading Act*, R.S.C. 1970, c. B-6; the *Carriage of Goods by Water Act*, R.S.C. 1970, c. C-15; the *Carriage by Air Act*, R.S.C. 1970, c. C-14; as well as regulations under some of these and other statutes such as the *Canada Grain Act*, R.S.C. 1970, c. G-16, and the orders of the Board of Railway Commissioners and its successor establishing the form of railway and truck bills of lading.

Delivery, as defined in *The Sale of Goods Act*,<sup>6</sup> does not coincide with the layman's understanding of the term. It means the transfer of possession of goods from the seller to the buyer. The concept does not require the physical movement of goods. Regrettably, neither the Code nor the Act is consistent in the use of the term. Delivery is sometimes used in its broad generic sense, and sometimes to describe the manner in which a transfer of possession may be effected: for example, by shipment or dispatch.<sup>7</sup> Further terminological confusion may be engendered by the failure to distinguish adequately between a *tender of delivery* and *delivery*.<sup>8</sup> The two concepts are distinct, and trigger different results and different obligations. Article 2 has made some progress in sorting out the terminological muddle. The process is not, however, complete, and a further effort seems worthwhile, particularly in the light of the precedents afforded by the Hague Uniform Law on the International Sale of Goods and the draft UNCITRAL Convention. So far, the terminological confusion seems to have caused the courts little difficulty.<sup>9</sup> While we do not wish to exaggerate the importance

<sup>6</sup>Section 1(1)(d).

<sup>7</sup>UCC 2-301, which corresponds to section 26 of *The Sale of Goods Act*, sets forth the seller's basic obligation "to transfer and deliver". Here, "deliver" seems to be used in the generic sense, as is true in section 26. ("Transfer" presumably refers to the transfer of title.) On the other hand, section 28(1) of *The Sale of Goods Act* clearly uses "place of delivery" in the sense of physical transfer. The Code sometimes uses "shipment" to denote the physical transfer element of delivery: for example, section 2-310(1)(a), place of shipment as place of delivery; section 2-501(b), "when goods are shipped"; section 2-505, "by or before shipment"; and, section 2-509(1), dealing with risk of loss in shipment contracts. At other times the Code uses the term "to send" to reflect this element of delivery, but generally does so when it wants to encompass both shipment and destination contracts; for example, section 2-310(1)(b) and section 2-504. This term is also used in *The Sale of Goods Act*, ss. 28(2) and 31(1). Section 31(2) also speaks of "delivery to a carrier", a term used by the Code in section 2-509(1)(a). Other modes of delivery used by the Code are as follows: delivery by document of title — sections 2-503(5) and 2-401(2); delivery at destination — sections 2-503(3), 2-504, and 2-509(1)(b); delivery without moving the goods — sections 2-503(4), 2-509(2) and 2-401(3).

<sup>8</sup>The Code defines "tender of delivery" in section 2-503(1) in terms parallel to the statement of delivery and payment as concurrent terms in section 27 of *The Sale of Goods Act*. (See, also, section 28(4), adding further elements, also contained in UCC 2-503(1).) Section 2-507(1) makes tender a condition precedent to the buyer's obligation to pay, and section 2-508 conditions the seller's right to cure on the act of tender. Curiously, section 2-509(1)(b) requires "tender" in a destination contract, while section 2-509(1)(a) speaks of "delivery" to a carrier in a shipment contract. Also to be noted are UCC 2-509(3), requiring only tender of delivery by non-merchants (rather than receipt by the buyer) to transfer risk, and UCC 2-511 obliging the buyer to tender payment upon the seller's tender of delivery. As to the meanings of tender in the Code, Official Comment No. 1 to section 2-503 states the two basic meanings as: (a) an offer coupled with present ability to fulfill all the conditions of the tendering party, followed by performance if the other party is ready to proceed; and, (b) an offer of goods or documents as if in fulfillment of the contractual conditions even though there is a defect when measured against the contract obligation. The Comment adds that the first meaning prevails unless the context unmistakably indicates otherwise.

<sup>9</sup>Crawford, footnote 1 *supra*, at pp. 6-7, 80, recommends that "performance" be substituted for "delivery", but this would create difficulties since "performance" embraces *all* of a party's contractual obligations and, as ordinarily understood, is not confined to the delivery obligation.

of the problem, we nevertheless recommend that the revised Act should strive for greater clarity in the use of the term "delivery" and its various derivatives, and that it should also distinguish more clearly between "tender of delivery" and "delivery".

## 2. TIME OF DELIVERY

The long established rule, contained in section 28(2) of *The Sale of Goods Act*, is that, where no time is specified for delivery, the seller is bound to send the goods "within a reasonable time". The same common-sense rule is adopted in the Code.<sup>10</sup> As commentators have noted,<sup>11</sup> while the language of section 28(2) is restricted to delivery involving the physical movement of goods, the courts have applied this rule to all forms of delivery. It seems desirable to correct this minor anomaly in the revised Ontario Act, as has been done in UCC 2-309(1).<sup>12</sup> Accordingly, we recommend that, following UCC 2-309(1), the revised Act should make it clear that, where the contract itself specifies no time for delivery, the seller's obligation to deliver the goods within a reasonable time is not restricted to cases where the seller is to send the goods to the buyer, but applies to all forms of delivery.<sup>13</sup>

Time of delivery raises two other important questions. The first involves the consequences of a breach of the seller's obligation to deliver on time; the second is concerned with the binding effect of a waiver of such a breach, or the buyer's assent to an extension of time for delivery. As to the first question, section 11 of the Ontario Sale of Goods Act provides as follows:

11. Unless a different intention appears from the terms of the contract, stipulations as to time of payment are not of the essence of a contract of sale, and whether any other stipulation as to time is of the essence of the contract or not depends on the terms of the contract.

This cautious language does not accurately reflect the weight of jurisprudence, since it is well established<sup>14</sup> that in commercial contracts time of delivery is *prima facie* of the essence.<sup>15</sup> Indeed, the case law goes even further. If time of shipment constitutes part of the description of the goods, deviation from the term will entitle the buyer to reject the goods on this ground alone.<sup>16</sup> The Code approach is very different. As previously noted,<sup>17</sup> the *Uniform Sales Act* did not distinguish between warranties and conditions, and any breach of the seller's obligations, it would seem, triggered

<sup>10</sup>UCC 2-309(1), 1-204(2).

<sup>11</sup>Crawford, footnote 1 *supra*, pp. 18-20, citing *Allen v. Danforth Motors Ltd.* (1957), 12 D.L.R. (2d) 572 (Ont. C.A.); *Buddle v. Green* (1857), 27 L.J. Ex. 33; and, *Halsbury's Laws of England* (3rd ed., 1960), Vol. 34, s. 140, note (k).

<sup>12</sup>Section 2-309(1) provides as follows:

The time for shipment or delivery or any other action under a contract if not provided in this Article or agreed upon shall be a reasonable time.

<sup>13</sup>See, Draft Bill, s. 5.7.

<sup>14</sup>*Benjamin's Sale of Goods* (1974), para. 603, especially note 96.

<sup>15</sup>This matter is discussed in greater detail in chapter 6, *supra*, at pp. 147-49.

<sup>16</sup>*Bowes v. Shand* (1877), 2 A.C. 455 (H.L.).

<sup>17</sup>*Supra*, ch. 6, at p. 146.

the same consequences. Article 2 adopts the same position with the result, as section 2-601 informs us, that the buyer may reject the goods if the goods or tender of delivery fail "in any respect" to conform to the contract. This rule, known as the "perfect tender rule" is discussed in a later chapter in this Report.<sup>18</sup>

In an earlier chapter we recommended that,<sup>19</sup> for the purpose of determining the parties' remedies, the revised Act should eschew *a priori* characterization of contractual terms, and should draw a distinction between material or substantial breaches of the contract, and breaches of lesser significance. In light of this recommendation, the position of section 11 in the revised Act must be reconsidered. Since *a priori* characterization of the terms of a contract will be eschewed, it will no longer be appropriate to ask whether a stipulation as to time is of the essence of the contract. Rather, the question will be, how serious is the seller's breach? It would be possible to achieve the same result in the revised Act by introducing a provision indicating the circumstances in which breach of an obligation to perform by an agreed date will *prima facie* be deemed of a substantial or material character. We do not, however, favour such a presumptive rule, because the circumstances of individual cases differ too widely to admit of uniform treatment in all cases. For example, a contract for the sale of a new automobile for use by the purchaser is not the same as an overseas shipment of wheat which, to the knowledge of the seller, is likely to be resold by the buyer before delivery. The consequences of late delivery in the former case would ordinarily be much less severe than the consequences of late delivery in the latter. Accordingly, subject to recommendations contained in chapter 17, *infra*, we do not recommend that the revised Act should adopt a rule making time of delivery of the goods *prima facie* an essential term of the contract, or treating a breach with respect to time of delivery as amounting *prima facie* to a substantial breach of the contract. However, it should be clearly understood that this recommendation would not preclude the parties from adopting their own rule with respect to the importance of punctual delivery for the purposes of their contract.

The second question concerns waiver of the seller's obligation to deliver on time, and the buyer's assent to an extension of time. This is a common occurrence. Since there may be no consideration to support the buyer's indulgence,<sup>20</sup> to what extent is such a waiver binding? As noted in an earlier chapter,<sup>21</sup> the modern position appears to be governed by the somewhat uncertain boundaries of the doctrines of waiver and equitable estoppel. We have earlier recommended<sup>22</sup> the adoption of an explicit rule, similar to UCC 2-209, establishing the binding character of modifications of the terms of the contract agreed to in good faith, whether or not they are supported by consideration. If our recommendation is adopted, it will normally be unnecessary for the parties to rely on the existing doctrines of waiver and equitable estoppel.

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<sup>18</sup>*Infra*, ch. 16.

<sup>19</sup>*Supra*, ch. 6, sec. B.

<sup>20</sup>*Chas. Rickards Ltd. v. Oppenheim*, [1950] 1 K.B. 616 (C.A.).

<sup>21</sup>*Supra*, ch. 5, sec. 4(b).

<sup>22</sup>*Supra*, ch. 5, sec. 4(b)(ii).

### 3. PLACE AND FORM OF DELIVERY

As to the place and form of delivery, contractual stipulations may vary widely. Depending on the terms of the contract, the seller can satisfy his delivery obligations in a variety of ways. The most important distinction is between those contractual stipulations that require shipment of the goods and those that involve no movement. We deal with each of these situations in turn. In either event, documents of title may come into play and, where a right of disposal is reserved to the seller, their important role will need to be considered separately.

#### (a) SALES NOT INVOLVING SHIPMENT

Two questions occur in connection with sales not involving shipment. The first is concerned with the rules that should govern the place of delivery, absent contractual agreement between the parties. The second concerns delivery where the goods are in the possession of a third party.

##### (i) *Delivery at Seller's Place of Business or Residence*

Section 28(1) of *The Sale of Goods Act* provides as follows:

28.(1) Whether it is for the buyer to take possession of the goods or for the seller to send them to the buyer is a question depending in each case on the contract, express or implied, between the parties, and apart from any such contract, express or implied, the place of delivery is the seller's place of business, if he has one, and if not, his residence, but where the contract is for the sale of specific goods that to the knowledge of the parties, when the contract is made, are in some other place, then that place is the place of delivery.

UCC 2-308(a) and (b) contain provisions to the same effect. Neither section, however, indicates the position where the seller has more than one place of business or residence.<sup>23</sup> Although this omission does not appear to create difficulties in practice, it seems desirable to clarify the position in the revised Act. We therefore recommend adoption in the revised Act of the following presumptive rules, which should apply when the parties' agreement contains no contrary provision:<sup>24</sup>

The place for delivery of goods under a contract of sale is governed by the following rules:

1. If the seller has only one place of business, it is the place for delivery.
2. If the seller has two or more places of business only one of which is known to the buyer, that one is the place for delivery.
3. If the seller has two or more places of business and the

<sup>23</sup>*Benjamin's Sale of Goods* (1974), para. 597. Nor does section 28 deal with the position where there is a change in the place of business or residence between the time of the making of the contract and the time of performance. We have not thought it necessary to deal with this problem in the Draft Bill.

<sup>24</sup>See, Draft Bill, s. 5.6.

buyer knows two or more of them, the one at or from which the seller conducted the negotiations is the place for delivery.

4. If the seller has no place of business, his residence is the place for delivery.

5. If the seller has no place of business and two or more residences only one of which is known to the buyer, that one is the place for delivery.

6. If the seller has no place of business and two or more residences and the buyer knows two or more of them, the one at or from which the seller conducted the negotiations for the sale is the place for delivery.

7. Where in a contract of sale of identified or unascertained goods the parties knew at the time of contracting that the goods were or were to be drawn from bulk or manufactured or produced at a particular place, that place is the place for delivery.

Rules 1 and 4 reproduce the existing provisions in section 28(1) of *The Sale of Goods Act* and UCC 2-308(a). Rules 2 and 5 deal, respectively, with the cases where the seller has more than one place of business or more than one residence, but the buyer is not aware of the fact. In both cases the Draft Bill adopts as the place of delivery that place of business or residence which is known to the buyer. Where the buyer knows that the seller has more than one place of business or more than one residence, rules 3 and 6 adopt as the place of delivery the place of business or residence from which the seller conducted the negotiations. Finally, rule 7, which is based on UCC 2-308(b) and Article 15(b) of the 1977 draft UNCITRAL Convention, deals with the position where the parties knew at the time of contracting that the goods were located or were to be drawn from bulk or manufactured or produced at a particular place. Here the parties' intention is assumed to be, in the absence of contrary agreement, that that place is to be the place of delivery.

#### (ii) *Delivery of Goods in Possession of Another*

It frequently happens, especially in sales involving commodities, that goods are held in storage by a warehouseman or other bailee. In such a case, section 28(3) of *The Sale of Goods Act* applies. This provision reads as follows:

28.(3) Where the goods at the time of sale are in the possession of a third person, there is no delivery by the seller to the buyer unless and until such third person acknowledges to the buyer that he holds the goods on his behalf, but nothing in this section affects the operation of the issue or transfer of any document of title to goods.

Under the subsection, there is no delivery by the seller to the buyer unless and until the third person acknowledges to the buyer that he holds the goods on his behalf. It is, however, made clear that the provisions of the subsection do not affect the issuance or transfer of any document of title to goods. Section 2-503(4) of the Code is considerably more detailed, and provides as follows:

2-503.(4) Where goods are in the possession of a bailee and are to be delivered without being moved

- (a) tender requires that the seller either tender a negotiable document of title covering such goods or procure acknowledgment by the bailee of the buyer's right to possession of the goods; but
- (b) tender to the buyer of a non-negotiable document of title or of a written direction to the bailee to deliver is sufficient tender unless the buyer seasonably objects, and receipt by the bailee of notification of the buyer's rights fixes those rights as against the bailee and all third persons; but risk of loss of the goods and of any failure by the bailee to honor the non-negotiable document of title or to obey the direction remains on the seller until the buyer has had a reasonable time to present the document or direction, and a refusal by the bailee to honor the document or to obey the direction defeats the tender.

With minor changes, the Code provisions essentially reproduce the provisions in section 43 of the *Uniform Sales Act*.<sup>25</sup> However, the Code provisions differ in some respects from existing Anglo-Canadian law, and it is desirable to consider whether the Code rules should be adopted in the revised Ontario Act.

The effect of the transfer of a negotiable document of title between the parties is the same in Canadian law as under the Code; that is, *prima facie*, it transfers title and constructive possession of the goods to the buyer. The adoption of subsection (4)(a) would not, therefore, effect any change in the existing Canadian position. The important changes would be introduced by the adoption of subsection (4)(b). Under existing Canadian law, transfer of a non-negotiable document of title does not effect a transfer of possession of the goods until the bailee has been notified and has acknowledged the transfer.<sup>26</sup> Subsection (4)(b) would change the position by fixing the buyer's rights vis-à-vis the bailee and all third persons as soon as the bailee has been notified of the transfer, although risk of loss would remain with the seller until the buyer has had a reasonable time to present the document.

Three objections have been raised to the provisions of UCC 2-503 (4)(b).<sup>27</sup> The first is that notification to the bailee by persons other than the buyer could have unexpected and undesirable consequences from the buyer's point of view. A second objection is that the bailee should not become obligated to the buyer against his will. A third objection concerns uncertainty created for the seller. While we appreciate these concerns, we are of the view that they can be answered satisfactorily.

<sup>25</sup>See, NYLRC Study, ch. 5, footnote 52, *supra*, at pp. (469)-(470).

<sup>26</sup>See, *Checkik v. Price* (1911), 18 W.L.R. 253 (Man. S.C., Tr. Div.); *Richardson v. Gray* (1869), 29 U.C.Q.B. 360 (C.A.); *The Warehouse Receipts Act*, R.S.O. 1970, c. 489, s. 21(2).

<sup>27</sup>Crawford, footnote 1 *supra*, at pp. 30-31.

So far as the first objection is concerned, it seems clear that notification of the transfer to the bailee enures for the buyer's benefit, and will not prejudice his position. In particular, there appears to be no basis for the fear that the buyer's special property rights, rights of replevin, or risk of loss will be affected to his detriment, since these incidents of the contract of sale are governed by separate provisions of the Code.

As to the second objection, the question whether the bailee should attorn to the buyer is a little more difficult. At common law, an assignment of a chose is perfected by notice to the account debtor; there does not appear, in our view, to be any sound reason for treating a bailee of goods more favourably.<sup>28</sup> Sections 20 and 21 of the Ontario Warehouse Receipts Act<sup>29</sup> also recognize that notification of a transfer is sufficient to bind a warehouseman. On the other hand, section 28(2) of *The Personal Property Security Act*<sup>30</sup> appears, in somewhat ambiguous language, to have retained the requirement of attornment for the purpose of perfecting a security interest in a non-negotiable document of title. It appears to us that the Code position better reflects mercantile practice, and we see no reason for a rule requiring the bailee to attorn to the buyer.

A third objection to UCC 2-503(4)(b) involves the uncertainty created for the seller as a result of the rule adopted in subsection (4)(b), that transfer of risk does not occur until the buyer has had a reasonable time to present the document to the bailee. The answer to this objection appears to be that the provision was inserted for the seller's benefit; without such a requirement, the buyer could postpone the transfer of risk for an indefinite period of time. This would obviously be more unsatisfactory from the seller's point of view than the very modest uncertainty created by the concept of a reasonable delay in the presentation of the document. We do not, therefore, favour any change in subsection (4)(b) in this respect.

Accordingly, the Commission recommends the adoption in the revised Act of both subsections (a) and (b) of UCC 2-503(4). We also recommend an amendment to section 28(2) of *The Personal Property Security Act*, in order to bring it into harmony with the provisions in the revised Act comparable to UCC 2-503(4)(b), and with sections 20 and 21 of *The Warehouse Receipts Act*.

#### (b) SALES INVOLVING SHIPMENT

Sales involving shipment are governed by section 31 of the Ontario Sale of Goods Act. This section provides as follows:

31.(1) Where in pursuance of a contract of sale the seller is authorized or required to send the goods to the buyer, the delivery of the goods to a carrier whether named by the buyer or not, for the purpose of transmission to the buyer, is *prima facie* a delivery of the goods to the buyer.

<sup>28</sup>See, Baer, "Documents of Title", Research Paper No. IV.3, at p. 21.

<sup>29</sup>R.S.O. 1970, c. 489.

<sup>30</sup>R.S.O. 1970, c. 344, as amended.

(2) Unless otherwise authorized by the buyer, the seller shall make a contract with the carrier on behalf of the buyer that is reasonable having regard to the nature of the goods and the other circumstances of the case, and if the seller omits so to do and the goods are lost or damaged in course of transit, the buyer may decline to treat the delivery to the carrier as a delivery to himself or may hold the seller responsible in damages.

The corresponding Code provisions appear in section 2-504, and read as follows:

2-504. Where the seller is required or authorized to send the goods to the buyer and the contract does not require him to deliver them at a particular destination, then unless otherwise agreed he must

- (a) put the goods in the possession of such a carrier and make such a contract for their transportation as may be reasonable having regard to the nature of the goods and other circumstances of the case; and
- (b) obtain and promptly deliver or tender in due form any document necessary to enable the buyer to obtain possession of the goods or otherwise required by the agreement or by usage of trade; and
- (c) promptly notify the buyer of the shipment.

Failure to notify the buyer under paragraph (c) or to make a proper contract under paragraph (a) is a ground for rejection only if material delay or loss ensues.

The two sets of provisions are substantially the same, but a number of differences deserve to be noted.

First, section 2-504(a) omits the statement in section 31(2) of *The Sale of Goods Act* that the seller's contract with the carrier shall be made "on behalf of the buyer". This reference to an agency relationship may create difficulties, both in determining its incidents, and in reconciling its existence with those cases where the bill of lading is issued to the order of the seller.<sup>31</sup> The Code's neutral position is, therefore, to be preferred. In other respects, the requirements under section 2-504(a) reflect those of the existing common law.<sup>32</sup>

A second difference is raised by UCC 2-504(b). Subsection (b)

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<sup>31</sup>Compare, Crawford, footnote 1 *supra*, at pp. 35-36, citing *Vancouver Milling & Grain Co. Ltd. v. C.C. Ranch Co. Ltd.*, [1924] 2 D.L.R. 569 (Alta. S.C., App. Div.), *aff'd* [1924] S.C.R. 671; and *Mayhew v. Scott Fruit Co.* (1915), 21 D.L.R. 54 (Alta. S.C., App. Div.). See, also, Atiyah, *The Sale of Goods* (5th ed., 1975), at pp. 223-24.

<sup>32</sup>See, *Benjamin's Sale of Goods* (1974), para. 594. For examples of what constitutes an unreasonable contract or insufficient delivery in the several jurisdictions, see: *Thomas Young & Sons Ltd. v. Hobson and Partners* (1949), 65 T.L.R. 365 (C.A.); *B.C. Fruit Market Ltd. v. Nat. Fruit Co.* (1921), 59 D.L.R. 87 (Alta. S.C., App. Div.); *A.M. Knitwear v. All-America Export-Import Corp.* (1976), 20 U.C.C. Rep. 581 (N.Y. Ct. App.).

obligates the seller to obtain and promptly deliver or tender in due form any document necessary to enable the buyer to obtain possession of the goods. This provision has no counterpart in section 31 of *The Sale of Goods Act*. The requirement is, however, probably already implied at law<sup>33</sup> and is, in any event, necessary to give business efficacy to the parties' agreement.

There is a third difference. The seller's obligation to notify the buyer promptly of the shipment, contained in UCC 2-504(c), again has no counterpart in section 31 of *The Sale of Goods Act*. This requirement corresponds with a similar requirement in section 2-503(1) involving a tender of delivery. Section 32(3) of the U.K. *Sale of Goods Act*<sup>34</sup> contains a more restricted notification requirement where goods are shipped by sea "under circumstances in which it is usual to insure".<sup>35</sup> Its clear purpose is to enable the buyer to effect insurance; hence, the subsection does not apply where it is the seller's duty to insure.<sup>36</sup> The issue that concerns us is whether the notice should be restricted to defined modes or transactions and for limited purposes as in the U.K. model, or whether the requirement should apply universally, as under the Code. If one accepts, as we do, that the buyer's interest in receiving notification is not restricted to protecting his insurance interest, but includes such matters as making arrangement for the receipt of the goods, then the merits of the Code's approach are compelling. However, even under the Code, there may be situations in which the buyer would not expect separate notification of shipment and would not be prejudiced by its absence. We do not read UCC 2-504(c) as imposing an inflexible requirement: as the opening words of the section indicate, all provisions of UCC 2-504 yield to contrary agreement, including, of course, the usages prevailing in a given trade and any previous course of dealing between the parties.

Assuming notification is required, a subsidiary question arises with respect to the consequences of the seller's breach of the obligation to notify. Section 32(3) of the U.K. Act provides that, if the seller is in default, the goods shall be deemed to be at his risk during sea transit.<sup>37</sup> This language has been criticized<sup>38</sup> on two grounds: first, it requires no

<sup>33</sup>This is certainly true in c.i.f. contracts (see, Benjamin, *supra*, para. 1539), and was assumed by the NYLRC Study, ch. 5, footnote 52, *supra*, at p. (431) to be generally true.

<sup>34</sup>56 & 57 Vict., c. 71 (U.K.).

<sup>35</sup>The Ontario Sale of Goods Act omits this provision, but in *Boyd v. Montour Coal & Coke Co.* (1923), 25 O.W.N. 115 (H.C.J.), it was held that, unless otherwise agreed, the seller must notify the buyer of the location of the goods at the point of transit.

<sup>36</sup>For example, in a c.i.f. contract: *Law & Bonar Ltd. v. British American Tobacco Co. Ltd.*, [1916] 2 K.B. 605; *Benjamin's Sale of Goods* (1974), para. 1433; Fridman, *Sale of Goods in Canada* (1973), at p. 259. In *Wimble, Sons & Co. v. Rosenberg & Sons*, [1913] 3 K.B. 743 (C.A.), it was also held that the subsection does not apply if the buyer has enough information to insure.

<sup>37</sup>See, *Benjamin's Sale of Goods* (1974), para. 1670. By contrast, in a contract calling for shipment c.i.f., the seller would be in breach for failure to insure: Benjamin, *supra*, paras. 1670 and 1524-34; Fridman, footnote 36 *supra*, at p. 260.

<sup>38</sup>Atiyah, footnote 31 *supra*, at pp. 222-24. See, also, *Wimble, Sons & Co. v. Rosenberg & Sons*, [1913] 3 K.B. 743 (C.A.).

causal relationship between the loss and the seller's failure to notify; and secondly, it is inconsistent with the consequences of a breach of the obligations implied in section 32(2). By way of contrast, UCC 2-504 provides that failure to notify, or to make a proper contract of carriage, is only a ground for rejection if material delay or loss "ensues". This appears to predicate a causal relationship. However, as has been noted,<sup>39</sup> a new difficulty arises under this provision. Section 2-509(1) only transfers the risk of loss to the buyer where the goods have been "duly" delivered to the carrier; the test of dueeness is not satisfied if the seller has failed to meet his statutory obligations. We have dealt previously<sup>40</sup> with the latter difficulty. Apart from this feature, our view is that there is no need to spell out separately the consequences of a breach of the seller's shipment obligations, but that they should be governed by the same remedial rules as are applicable to other breaches by the seller.

Accordingly, we recommend that the revised Act should adopt a provision similar to UCC 2-504 dealing with the seller's obligations in the case of a sale involving shipment, in preference to section 31 of the existing Sale of Goods Act; however, the reference in the concluding sentence of UCC 2-504 to the consequences of the seller's failure to notify or to make a proper contract of transportation should be omitted.<sup>41</sup>

(C) CHARACTER AND EFFECT OF SELLER'S RESERVATION  
OF RIGHT OF DISPOSAL<sup>42</sup>

Ordinarily, in the absence of protective measures, the effect of the seller's delivery of goods to an independent carrier is to deprive him both of the title to the goods and of his right of lien or retention in respect of the unpaid purchase price. The first result would ensue because, under the presumptive rules in section 19 of *The Sale of Goods Act*, passage of title would normally occur not later than the entrustment of the goods to the carrier. The second result would occur because a right of lien or retention is dependent on the seller's retaining possession of the goods.<sup>43</sup> Delivery to the carrier will normally terminate the seller's lien or right of retention because section 41(1)(a) of the Act so provides, and because of the provision in section 31(1) that delivery to a carrier is *prima facie* deemed to be delivery to the buyer. As a result of the combined operation of these rules, the unpaid seller would therefore find himself without any

<sup>39</sup>Honnold, in NYLRC Study, ch. 5, footnote 52, *supra*, at p. (472).

<sup>40</sup>*Supra*, ch. 11, sec. 2(c)(ii)(1).

<sup>41</sup>See, Draft Bill, s. 7.3.

<sup>42</sup>As noted previously, UCC 2-401(1) deals generally with the effect of reservation of title after shipment by the seller. We have earlier recommended adoption of this provision in place of section 20(1) of the existing Sale of Goods Act (see, *supra*, ch. 11, sec. 2(h)). The present discussion deals with a particularized application of the general principle with respect to the issuance of a bill of lading. See, further, generally: *Benjamin's Sale of Goods* (1974), paras. 383-91; *The Sale of Goods Act*, s. 19, Rule 5(ii), and s. 20. As to the right of disposal in the case of bills of lading, see: Benjamin, para. 1405; Sassoon, *C.I.F. and F.O.B. Contracts* (2nd ed., 1975) (*British Shipping Laws*, Vol. 5), pp. 195 *et seq.*, and 365 *et seq.*; Lagergren, *Delivery of the Goods* (1954), pp. 108-17.

<sup>43</sup>*The Sale of Goods Act*, s. 39(1).

security for payment of the purchase price, where payment is not due until some time subsequent to the shipment of the goods.

Before the advent of modern forms of credit financing, it was for a long time customary for sellers, who wished to protect themselves against this danger in cash transactions, to have the bill of lading issued to their order. In overseas transactions, this is still a common practice, in conjunction with letters of credit forms of payment. In this way, the seller obtains the benefit of section 20(2) of *The Sale of Goods Act* which provides that, where goods are shipped and by the bill of lading the goods are deliverable to the order of the seller or his agent, the seller *prima facie* reserves the right of disposal. There is also some authority, slender though it may be, that issuance of the bill of lading to the seller's order may displace the *prima facie* rule in section 31(1) of *The Sale of Goods Act*,<sup>44</sup> so that the seller retains constructive possession as well as the right of disposal with respect to the goods.

Although the legitimacy of reserving the right of disposal by this means is fully recognized in section 20(2) of the Act, there are several difficulties that have provoked much difference of opinion among writers and in the decisions. The first, apparently a question of fact or of mixed fact and law, is whether, by having the bill of lading issued to his order, the seller has in fact evinced an intention to reserve the right of disposal. This difficulty arises because, according to section 20(2) of the Act, the form of the bill is only *prima facie* evidence of such an intention. The second difficulty involves the meaning of "right of disposal". This expression is not defined in *The Sale of Goods Act*, but might suggest a limited interest falling short of legal title. According to Williston,<sup>45</sup> the seller reserves legal title, although it should be noted that this view is by no means uncontroverted. The third difficulty, assuming Williston's view is correct, is to determine the nature of the legal title reserved by the seller. The case law appears to leave it unsettled whether it is an absolute title,<sup>46</sup>

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<sup>44</sup>See, *supra*, ch. 13, footnote 30 and text thereto.

<sup>45</sup>Williston *on Sales*, (Rev. ed., 1948), Vol. 2, sec. 283: "There seems no doubt that the seller who thus consigns the goods to himself has complete control over them, and that the so-called *jus disponendi* is in fact title."

<sup>46</sup>This position is put forward in *Wait v. Baker* (1848), 2 Exch. 1 (which stressed an alleged difference between delivery of the goods to the master of a vessel as a person carrying goods on behalf of the seller, and delivery to the ship as a common carrier); *Mirabita v. Imperial Ottoman Bank* (1878), 3 Ex. D. 164, at 172, *per* Cotton, L.J., (but there it was held that, to reserve an absolute property, the seller had to follow a certain course of action); *Ross T. Smyth & Co. Ltd. v. T.D. Bailey, Son & Co.*, [1940] 3 All E.R. 60 (H.L.), *per* Lord Wright at p. 68 (stressing the financing aspects as requiring the seller to retain a general property interest); *Benjamin's Sale of Goods* (1974), paras. 1699 *et seq.* The case of *Browne v. Hare* (1858), 3 H. & N. 484, 157 E.R. 561 (Exch.), *aff'd* (1859), 4 H. & N. 822, 157 E.R. 1067 (Exch.), analyzed the question in terms of intent. *Mirabita*, itself, seemed to hold that the buyer and seller both had property interests in the goods on the stated facts.

or simply a security title.<sup>47</sup> The Ontario cases<sup>48</sup> seem generally to favour the first view, and have in this way reached conclusions which, while logically consistent, are open to question on functional grounds.

Williston,<sup>49</sup> on the other hand, was not in doubt about the correct characterization of the seller's reservation of title: it was only by way of security, in the same way that a mortgagee holds title. This view was incorporated in section 20 of the *Uniform Sales Act*.<sup>50</sup> UCC 2-505 has built upon, and somewhat enlarged, the provisions of the *Uniform Sales Act*. UCC 2-505 provides as follows:

2-505.(1) Where the seller has identified goods to the contract by or before shipment:

- (a) his procurement of a negotiable bill of lading to his own order or otherwise reserves in him a security interest in the goods. His procurement of the bill to the order of a financing agency or of the buyer indicates in addition only the seller's expectation of transferring that interest to the person named.
- (b) a non-negotiable bill of lading to himself or his nominee reserves possession of the goods as security but except in a case of conditional delivery (subsection (2) of Section 2-507) a non-negotiable bill of lading naming the buyer as consignee reserves no security interest even though the seller retains possession of the bill of lading.

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<sup>47</sup>This position may have originated in *Ogg v. Shuter* (1875), 1 C.P.D. 47 (C.A.), in the opinion of Lord Cairns, speaking for himself, Kelly, C.B., Bramwell, B., and Blackburn, J., at pp. 50-51. This approach was also taken in *The Parchim*, [1918] A.C. 157 (P.C.), and in *Frebold and Sturznickel (Trading as Panda O.H.G.) v. Circle Products Ltd.*, [1970] 1 Lloyd's Rep. 499 (C.A.), at pp. 504-05. It is also favoured by Sassoon, footnote 42 *supra*, paras. 424, 429; Carver, *Carriage by Sea* (12th ed., 1971) (*British Shipping Laws*, Vol. 3), para. 1066, arguing that for the seller to reserve the right of disposal in an f.o.b. contract is a breach of his obligations; Atiyah, footnote 31 *supra*, at pp. 224-25; and, Lagergren, footnote 42 *supra*, at pp. 112-16. Compare, *Scrutton on Charterparties* (17th ed., 1964), at p. 179.

<sup>48</sup>For example, *Scott v. Melady* (1900), 27 O.A.R. 193; *Vipond v. Sisco* (1913), 29 O.L.R. 200 (App. Div.). In both of these cases it was held, *inter alia*, that the property in the goods remained with the seller, and that he was not entitled to sue for the price even assuming the buyer had wrongfully refused to accept and pay for the goods. See, Sassoon, footnote 42 *supra*, paras. 441 to 442.

<sup>49</sup>Williston, footnote 45 *supra*, secs. 283-84, 305. Compare, Note, "Significance of the Concept 'Title' Where the Seller Retains the Bill of Lading to Goods" (1929), 29 Colum. L. Rev. 1100, stating that the American common law position was generally considered to be that the seller retained an absolute title but that, on closer analysis, the matter was not so simple.

<sup>50</sup>Section 20(2) of the *Uniform Sales Act* provides as follows:

Where goods are shipped, and by the bill of lading the goods are deliverable to the seller or his agent, or to the order of the seller or of his agent, the seller thereby reserves the property in the goods. But if, except for the form of the bill of lading, the property would have passed to the buyer on shipment of the goods, the seller's property in the goods shall be deemed to be only for the purpose of securing performance by the buyer of his obligations under the contract.

(2) When shipment by the seller with reservation of a security interest is in violation of the contract for sale it constitutes an improper contract for transportation within the preceding section but impairs neither the rights given to the buyer by shipment and identification of the goods to the contract nor the seller's powers as a holder of a negotiable document.

It will, therefore, be seen that there are differences in substance between section 20(2) of *The Sale of Goods Act* on the one hand, and the provisions of the *Uniform Sales Act* and those of the *Uniform Commercial Code*, on the other. These differences, and others, are apparent from the following comparative table.

**TABLE 1**  
Reservation of Rights of Disposal:  
Comparison of  
*SGA 20(2)*, *USA 20*, and *UCC 2-505*<sup>51</sup>

	<i>SGA</i>	<i>USA</i>	<i>UCC</i>
1. (Negotiable) bill of lading to order of seller or agent	Reserves right of disposal	Reserves right of disposal, but only as security interest: 20(2)	Reserves right of disposal, but only as security interest: 2-505 (1)(a)
2. (Non-negotiable) bill of lading to seller or nominee	No express mention	Reservation of security interest: 20(2)	"Possession . . . as security"; 2-505(1)(b)
3. (Negotiable) bill of lading to order of buyer	No express mention	Reservation of right of possession of goods: 20(3)	Reservation of security interest: 2-505(1)(a)
4. (Non-negotiable) bill of lading in buyer's name	No express mention	No express mention	No security interest in seller: 2-505 (1)(b)

It will be noted that section 2-505 distinguishes between a "security interest" in the goods<sup>52</sup> and "possession . . . as security".<sup>53</sup> A learned commentator has suggested<sup>54</sup> that no difference in result was intended. The distinction is anomalous in view of the definition of security interest

<sup>51</sup>Unlike UCC 2-505, section 20(2) of *The Sale of Goods Act* and section 20 of the *Uniform Sales Act* do not distinguish between negotiable and non-negotiable bills of lading. In deference to this difference, we have bracketed the references to "negotiable" and "non-negotiable" bills of lading in the table. For further discussion of this terminological issue, see *supra*, ch. 13, sec. 1.

<sup>52</sup>Subsection (1)(a).

<sup>53</sup>Subsection (1)(b).

<sup>54</sup>Honnold, in NYLRC Study, ch. 5, footnote 52, *supra*, p. (475).

in section 1-201(37) of the Code. This definition draws no distinction between possessory and non-possessory interests, but defines a security interest, *inter alia*, as an interest in personal property or fixtures that secures payment or performance of an obligation.

The consequences of characterizing the seller's interest in the bill of lading as a security interest<sup>55</sup> will vary with the nature of the problem. For residual title purposes, the buyer will be deemed to be the owner of the goods pursuant to the general rule laid down in UCC 2-401(1).<sup>56</sup> This could make a significant difference in third party situations. Between seller and buyer, the result will be less dramatic since, as previously noted, their rights and duties are issue oriented, and rarely turn on the locus of title.

Ontario has already committed itself, in *The Personal Property Security Act*, to the Code's concept of the nature of a security interest. Consistency suggests that the same characterization should be applied to the seller's reservation of a right of disposal after shipment. Moreover, as we have noted, the provisions of UCC 2-505 are more comprehensive than those of section 20(2) of *The Sale of Goods Act*; for example, as is apparent from Table 1 set out above, UCC 2-505 distinguishes between negotiable and non-negotiable documents of title. We therefore recommend that the essential features of UCC 2-505 should be adopted in the revised Act in lieu of section 20(2) of the existing Act, subject to the elimination of the distinction between "security interest" and "possession . . . as security" referred to above.<sup>57</sup>

If our recommendation is adopted, an appropriate amendment to *The Personal Property Security Act* should also be considered. Section 3(2) of *The Personal Property Security Act* states that the rights of buyers and sellers under sections 20(2), 39, 40, 41 and 43 of *The Sale of Goods Act* are not affected by *The Personal Property Security Act*. The latter Act is based upon Article 9 of the *Uniform Commercial Code* and, by way of contrast, UCC 9-113 provides as follows:

9-113. A security interest arising solely under the Article on Sales (Article 2) is subject to the provisions of this Article except that to the extent that and so long as the debtor does not have or does not lawfully obtain possession of the goods

- (a) no security agreement is necessary to make the security interest enforceable; and
- (b) no filing is required to perfect the security interest; and
- (c) the rights of the secured party on default by the debtor are governed by the Article on Sales (Article 2).

As will be noted, the impact of Article 9 on the seller's reservation of the right of disposal is modest, so long as the buyer has not obtained posses-

<sup>55</sup>The same observation applies to a reservation of title not represented by a document of title.

<sup>56</sup>*Supra*, ch. 11, sec. 2(h).

<sup>57</sup>See, Draft Bill, s. 7.4.

sion of the goods. We are persuaded by the merits of UCC 9-113, and accordingly recommend that consideration be given to amending section 3(2) of *The Personal Property Security Act* in accordance with the Code provision.

A final observation is in order on a constitutional point. The seller's right of disposal under section 20(2) of the existing Ontario Sale of Goods Act is not confined to bills of lading subject to provincial jurisdiction. We are not aware of any conflict between this subsection and federal legislation governing documents of title. Accordingly, we have not thought it necessary to restrict the application of our recommended draft provision in a way that section 20(2) is not now restricted.

#### 4. THE USE OF MERCANTILE TERMS

For over 150 years, the custom of merchants dealing in international trade has been to describe their mutual obligations of performance in a symbolic shorthand of initials and words. The commonest of these are 'f.o.b.' and 'c.i.f.', which signify 'free on board' and 'cost, insurance and freight' respectively.<sup>58</sup> In North America, these terms have not been restricted to use in export transactions, or to shipment by sea.<sup>59</sup> Their earliest use in Canada was in connection with the internal or domestic Great Lakes grain trade,<sup>60</sup> but they were soon extended to carriage by rail, and are now also used in truck shipments. The different types of shipping terms, and the frequency of their use among the respondents to the C.M.A. Questionnaire, are shown in Table 2, set out below.

TABLE 2  
SHIPPING TERMS<sup>61</sup>

	<i>Always or often %</i>	<i>Mid %</i>	<i>Rarely or never %</i>
(a) Ex works (factory, warehouse, etc.)	42.1	22.3	35.5
(b) F.O.R. — F.O.T. (free on rail — truck) named departure point	8.0	14.4	77.6
(c) F.A.S. (free alongside ship) named port of shipment	2.6	9.0	88.5

<sup>58</sup>Crawford, footnote 1 *supra*, p. 42. The terms 'f.o.b.' and 'c.i.f.' are not defined in *The Sale of Goods Act*, but have been intensively analyzed by the British courts. See, *Benjamin's Sale of Goods* (1974), chs. 19-21; and generally, Sassoon, *C.I.F. and F.O.B. Contracts*, (2nd ed., 1975) (*British Shipping Laws*, Vol. 5). The Code provides a set of definitions in sections 2-319 to 2-323.

<sup>59</sup>Crawford, footnote 1 *supra*, at pp. 42-43.

<sup>60</sup>*Wilmut v. Wadsworth* (1853), 10 U.C.Q.B. 594; *Howland v. Brown* (1856), 13 U.C.Q.B. 199.

<sup>61</sup>Source: Fisher, "Analysis of Computer Tabulation of Responses to Questionnaire Distributed to Ontario Members of the Canadian Manufacturers' Association", Research Paper No. I.2, Table 19, p. 55. ("Always" and "rarely" are used in the original table as condensed terms and have the meaning ascribed to them in the above columnar headings.)

(d) F.O.B. (free on board) named port of shipment	36.6	22.6	40.7
(e) C. & F. (cost and freight) named port of destination	4.1	10.8	85.1
(f) C.I.F. (cost, insurance, freight) named port of destination	6.9	15.7	77.5
(g) Freight or carriage paid to named point of destination (inland)	20.5	30.8	48.7
(h) Ex ship — named port of destination	1.2	3.7	95.7
(i) Ex quay — named port of destination	0.8	2.3	96.5
(j) Other	7.7	3.7	88.5

It will be noted that, while shipment "ex works" is the single most common term,<sup>62</sup> "f.o.b. named port of shipment"<sup>63</sup> comes a close second,<sup>64</sup> and that, when combined, the various other forms of shipment terms substantially exceed in frequency sales made "ex works". However, frequency of use is not coterminous with agreement as to the meaning of the terms used, or variations thereof. To what extent, therefore, should the revised Ontario Act follow the lead of Article 2 in providing an authoritative catalogue of definitions? The preliminary, but far from exhaustive, inquiries made on our behalf indicate considerable sympathy for such an enterprise. The Canadian decisions interpreting the meaning of shipping terms are modest in number, and the courts have generally resorted to British precedents. We were advised that, even among shipping managers, the terms are not always fully understood, and that their statutory codification might help to dispel some of the uncertainty.

It goes without saying that no final decision should be taken without further and comprehensive consultation with the interested parties. Assuming the reaction remains positive, two further questions arise: (a) which model should be adopted; and, (b) what provision should be made with respect to the impact of containerization?

#### (a) WHICH MODEL?

There are only two approaches that seriously commend themselves as precedents: namely, the provisions in sections 2-319 to 2-323 of the *Uniform Commercial Code*, and the *Incoterms*<sup>65</sup> adopted by the International Chamber of Commerce. The two sets of terms have been compared for us,<sup>66</sup> and the overall conclusion appears to be that the differences

<sup>62</sup>42.1%.

<sup>63</sup>Presumably, this should read "point" of shipment since, in North American practice, the f.o.b. term is not confined to maritime shipments.

<sup>64</sup>36.6%.

<sup>65</sup>International Chamber of Commerce, *Incoterms 1953 and Supplement* (1974), (Brochure No. 274).

<sup>66</sup>See, Appendix 9 to this Report.

between them are modest. Nevertheless, there is little doubt in our minds that the Code terms make a more logical choice. We say this for two reasons. In the first place, the United States is our closest trading partner, and it is obviously desirable that Canadian and American businessmen should attach the same meaning to each other's trade terms. Secondly, the Article 2 definitions are better geared to North American practices and traditions since, unlike the *Incoterms*, they are not restricted to foreign trade contracts. Accordingly, we recommend that the revised Act incorporate a definition of common trade terms. The definitions contained in UCC 2-319 to 2-323 should be adopted in preference to the *Incoterms* promulgated by the International Chamber of Commerce.<sup>67</sup>

#### (b) IMPACT OF CONTAINERIZATION<sup>68</sup>

Containerization is a mode of shipment in which large numbers of packages or units are stored in sealed metal crates. The primary advantages of containerization are simplicity of handling and increased security. The container revolution, which began in the middle 1960's, has had its most significant impact so far on the overseas shipping trade. To a lesser extent, it has influenced domestic shipping, with most container carriage going to those carriers, known as "combined transport operators", who containerize the shipper's goods in anticipation of their shipment by sea. In the future, intermodal<sup>69</sup> domestic containerization may be expected to grow as regulatory difficulties are solved and shipper awareness of its advantages is increased.

The containerization process differs from traditional breakbulk carriage in many ways. First, it eliminates the individual handling of packages by carriers and forwarding agents,<sup>70</sup> thus making traditional bills of lading inappropriate for such carriage. Secondly, it complicates the process of determining which carrier is liable for damage to the goods, because the container is sealed by the first carrier and not opened until the destination is reached.<sup>71</sup> This may result in the initial carrier, usually the combined transport operator, bearing a greater burden of liability than in the past; it further points out the incongruous limitations on liability to which the various modes of carriage are now subject.<sup>72</sup> Thirdly,

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<sup>67</sup>See, Draft Bill, ss. 5.19-5.23 inclusive.

<sup>68</sup>For a general overview of Canadian developments at the non-legal level, see *The Financial Post*, "Special Report", July 8, 1978, pp. 29-34.

<sup>69</sup>That is, involving a number of modes of transport.

<sup>70</sup>Sassoon, "Trade Terms and the Container Revolution" (1969-70), 1 J. Mar. L. & Comm. 73, 78.

<sup>71</sup>*Benjamin's Sale of Goods* (1974), paras. 1835-36; Sassoon, footnote 70 *supra*, pp. 78-80.

<sup>72</sup>Article IV.5 of the Hague Rules, in force in Canada under the *Carriage of Goods by Water Act*, R.S.C. 1970, c. C-15, provides, *inter alia*, that the carrier shall not limit liability to an amount less than \$500. (This amount has become the standard.) The Hague-Visby Rules would raise the minimum to \$662. Compare, Sassoon, footnote 70 *supra*, p. 79, n. 22. Domestically, common carriers are generally held to the standard of insurers, escaping liability only

it raises new problems of passage of title and risk of loss as between buyer and seller,<sup>73</sup> especially where the contract is f.o.b. or c.i.f. and the seller is obliged to obtain a bill of lading. The reason, as some commentators have pointed out,<sup>74</sup> is that a clean bill of lading for "shipped" not "received" goods may not be obtainable. Fourthly, questions of what constitutes a package for purposes of liability limitations have only begun to be litigated,<sup>75</sup> and no uniform principles have yet emerged.

As now constituted, the usual requirements of a bill of lading (that is, that it be issued by a shipowner, not a forwarding agent,<sup>76</sup> that the goods be "on board" or "shipped"<sup>77</sup> and not "received", that it be "clean",<sup>78</sup> and that it should confirm storage under deck<sup>79</sup>) cannot ordinarily be

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where the damage is caused by an act of God or war: *Turgel Fur Co. Ltd. v. Northumberland Ferries Ltd.* (1966), 59 D.L.R. (2d) 1 (N.S. S.C.); *Boston & Maine Ry. v. Ratzkowski* (1921), 30 Que. K.B. 445 (C.A.). Liability may also be limited pursuant to statute: for example, the *Railway Act*, R.S.C. 1970, c. R-2, s.294(2), authorizing the Canadian Transport Commission to establish limitations on liability. Under the auspices of UNCITRAL, a Draft Convention on the Carriage of Goods by Sea, to replace the Hague Rules, was completed in 1976 and was considered at a Conference of Plenipotentiaries held in Hamburg in March, 1978. The proceedings at that Conference and the substance of the Convention that was there approved are described in Moore, "The Hamburg Rules" (1978), 10 J. Mar. L. & Comm. 1. The text of the *United Nations Convention on the Carriage of Goods by Sea, 1978* is reproduced at (1978), 10 J. Mar. L. & Comm. 147. See, further, Sweeney, "The UNCITRAL Draft Convention on Carriage of Goods by Sea" (1975-76), 7 J. Mar. L. & Comm. 69, 327, 487, 615, and *ibid.* (1977), 8 J. Mar. L. & Comm. 167; and Tetley *et al.*, "Canadian Comments on the Proposed Uncitral Rules" (1978), 9 J. Mar. L. & Comm. 251.

<sup>73</sup>*Benjamin's Sale of Goods* (1974), paras. 1843-45; Sassoon, footnote 70 *supra*, pp. 80 *et seq.*

<sup>74</sup>Sassoon, footnote 70 *supra*, pp. 81-82; *Benjamin's Sale of Goods* (1974), paras. 1840-41.

<sup>75</sup>The American cases are analyzed in Simon, "Container Law: A Recent Re-appraisal" (1976-77), 8 J. Mar. L. & Comm. 489. One line of cases, typified by *Royal Typewriter Co. v. M/V Kulmerland* (1973), 483 F. 2d 645 (U.S.C.A., 2nd Cir.), would treat the container as a package for purposes of the limitation on liability. The other line of cases, for example, *Matsushita Electric Corp. of America v. The S.S. Aegis Spirit* (1976), 414 F. Supp. 894 (W.D. Wash.), would hold that the law must "reflect the realities of the maritime industry of today", and that the container is really more like the hold of a ship, so that the actual packages contained within it are the packages to which reference should be made. So far, there appear to be no reported English cases. Compare, *Benjamin's Sale of Goods* (1974), para. 1838.

<sup>76</sup>International Chamber of Commerce, *Uniform Customs and Practice for Documentary Credits* (1974), art. 19a, (Brochure No. 290).

<sup>77</sup>*Ibid.*, para. 18.

<sup>78</sup>International Chamber of Commerce, *The Problem of Clean Bills of Lading*, (Brochure No. 283).

<sup>79</sup>To avoid the exclusion in the Hague Rules, Article 1(c). Some cases have now raised the question of when it may be said that a custom or usage has developed to permit shipment of containers on deck: for example, *du Pont de Nemours International S.A. v. S.S. Mormacvega* (1972), 367 F. Supp. 793 (S.D.N.Y.).

satisfied by container carriage. This fact indicates that the traditional rules will have to be adapted in time to conform to this new, and vastly more efficient, means of transportation. It may be that the terms f.o.b. and c.i.f. will have to be redefined to encompass container transport. Or, it may be that commerce will develop a new term or terms to signify the rights and duties of the parties where goods are shipped in this manner.<sup>80</sup>

Many problems have yet to be litigated, and commercial handling of these transactions is still evolving. We therefore conclude that any attempt to codify the law regarding the rights and obligations of sellers and buyers under a container transport of goods at this time would be premature, and might stunt the development of containerization.

## B. BUYER'S OBLIGATION TO PAY

### 1. TIME OF PAYMENT

Time of payment is governed by section 27 of the Ontario Sale of Goods Act. This section provides as follows:

27. Unless otherwise agreed, delivery of the goods and payment of the price are concurrent conditions, that is to say, the seller shall be ready and willing to give possession of the goods to the buyer in exchange for the price and the buyer shall be ready and willing to pay the price in exchange for possession of the goods.

The presumptive rule is that payment and delivery are concurrent conditions. *Prima facie*, therefore, the buyer is not entitled to any period of credit, however short. The results of the C.M.A. Questionnaire show,<sup>81</sup> however, that this statutory rule is rarely applied in practice.

Even where no period of credit has been agreed upon, it does not follow that failure to make punctual payment entitles the seller to terminate the agreement. Section 11 of the Act states that, unless otherwise provided, time of payment is not of the essence. The buyer's default will, of course, amount at least to a breach of warranty, and the seller will be entitled to exercise the rights of resale conferred upon him under section 46 of *The Sale of Goods Act*. These important matters, together with the Code's much stricter view of the importance of timely payment, will be discussed more fully in the chapter on seller's remedies.<sup>82</sup> The legal effect of the seller's waiver of his right to punctual payment, or his agreement to extend the time for payment, raises issues similar to those discussed earlier with respect to breach of the seller's obligation to deliver on time, and waiver by the buyer of his right to punctual delivery.<sup>83</sup> Our comments

<sup>80</sup>See, Ramberg, "The Combined Transport Operator", [1968] J. Bus. L. 133.

<sup>81</sup>Fisher, footnote 61 *supra*, Table 20, p. 58. Only 3.9% of the respondents regularly require payment on delivery, compared with 82.3% who stipulate that payment must be made within 30 days of delivery.

<sup>82</sup>*Infra*, ch. 16.

<sup>83</sup>*Supra*, this chapter, sec. A.2.

in connection with the latter situation are equally applicable in the present context. For reasons similar to those expressed in support of our recommendation concerning time of delivery, and subject to our further recommendations in chapter 16, we also recommend that the revised Act should not contain a rule characterizing the importance of terms with respect to the time of payment or characterizing the *prima facie* gravity of a breach thereof. Again, however, it should be clearly understood that the parties would be free to establish their own rules with respect to these questions. Problems arising out of the rule in *Pinnel's Case*,<sup>84</sup> and its statutory modification in *The Mercantile Law Amendment Act*,<sup>85</sup> have also been discussed earlier,<sup>86</sup> and need not be repeated here.

We now turn our attention to an issue of present concern: namely, how tender of payment is to be geared to individual modes of performance. Given the diverse forms of delivery, the rule of concurrent payment and delivery contained in section 27 of the Ontario Sale of Goods Act provides no clear answer to this issue. UCC 2-310, on the other hand, provides the greater particularity that is required. The section reads as follows:

2-310. Unless otherwise agreed

- (a) payment is due at the time and place at which the buyer is to receive the goods even though the place of shipment is the place of delivery; and
- (b) if the seller is authorized to send the goods he may ship them under reservation, and may tender the documents of title, but the buyer may inspect the goods after their arrival before payment is due unless such inspection is inconsistent with the terms of the contract (Section 2-513); and
- (c) if delivery is authorized and made by way of documents of title otherwise than by subsection (b) then payment is due at the time and place at which the buyer is to receive the documents regardless of where the goods are to be received; and
- (d) where the seller is required or authorized to ship the goods on credit the credit period runs from the time of shipment but post-dating the invoice or delaying its dispatch will correspondingly delay the starting of the credit period.

It will be noted that subsection (a) substantially modifies the conclusion that would otherwise follow from a literal application of the concurrent payment and delivery rule: payment is due, not when the goods are shipped or delivered to the carrier, but when they are "received" by the

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<sup>84</sup>(1602), 5 Co. Rep. 117a, 77 E.R. 237 (C.P.).

<sup>85</sup>R.S.O. 1970, c. 272.

<sup>86</sup>*Supra*, ch. 5, sec. 4(b).

buyer.<sup>87</sup> As the Official Comment to section 2-310 explains, the section has been drawn to reflect modern business methods of dealing at a distance rather than face to face. Postponement of the time of payment to the time of receipt enables the buyer to exercise his preliminary right of inspection before making payment, even though, under the terms of delivery, risk of loss may have previously passed to the buyer. We examine more fully in chapter 17 the general question of the time and place of the buyer's right of inspection and his cognate right of rejection of non-conforming goods. For the moment, we content ourselves with the following observations. We appreciate that the Code's rule in UCC 2-310(b) may be at variance with some early Ontario decisions<sup>88</sup> suggesting or holding that the buyer must inspect the goods at the place of shipment, regardless of where he actually receives, and is requested to pay for, the goods. However, at least some English decisions<sup>89</sup> have shown a disposition to imply a term bringing the time of inspection more in accord with mercantile expectations. Presumably, the influence of these decisions will also be felt in Canada. Even if this were not so, we are persuaded by the soundness of the Code's reasoning which, it will be observed, is only directed to a presumptive, not a conclusive, implied term of the parties' agreement. We recognize, too, that the Code's more buyer-oriented rule may prejudice the seller if the goods are subsequently rejected for alleged non-conformity. However, the Code<sup>90</sup> offers the seller a measure of reciprocity since, unlike existing Anglo-Canadian law, it does require a rejecting merchant buyer to follow the seller's reasonable instructions with respect to the goods and, in case of urgency, to take protective steps even without such instructions, if the seller has no agent or place of business at the market of rejection.

The other subsections of UCC 2-310 also appear to be in accord with mercantile understanding. Accordingly, we recommend that the revised Act should adopt, in place of section 27 of the existing Act, a provision comparable to UCC 2-310 insofar as this provision relates to time of payment.<sup>91</sup>

## 2. PAYMENT BEFORE INSPECTION

The parties' agreement, express or implied, may, of course, require payment by the buyer without a preliminary right to inspect the goods, as in the case of goods that are sold "C.O.D.". Similarly, payment may be required before the goods are even available for inspection, as in the

<sup>87</sup>With respect to the current rule, that payment and delivery are concurrent obligations, see, further, Atiyah, *The Sale of Goods* (5th ed., 1975), pp. 136-38.

<sup>88</sup>For example, Falconbridge, C.J., in *Craig v. Shaw* (1903), 2 O.W.R. 449 (Div. Ct.), leave to appeal refused 2 O.W.R. 508 (C.A.); *McLean Produce Co. v. Freedman* (1908), 12 O.W.R. 1038 (Tr. Div.); *Merrill v. Waddell* (1920), 47 O.L.R. 572 (C.A.).

<sup>89</sup>For example, *Molling & Co. v. Dean & Son Ltd.* (1901), 18 T.L.R. 217 (K.B.D.); *Boks & Co. v. J.H. Rayner & Co.* (1921), 37 T.L.R. 800 (C.A.).

<sup>90</sup>See, UCC 2-603.

<sup>91</sup>See, Draft Bill, s. 5.8.

case of documentary sales where the goods are in transit at the time of tender of the documents. These well known situations requiring payment before inspection are restated in UCC 2-513(3), which provides as follows:

2-513.(3) Unless otherwise agreed and subject to the provisions of this Article on C.I.F. contracts (subsection (3) of Section 2-321), the buyer is not entitled to inspect the goods before payment of the price when the contract provides

- (a) for delivery 'C.O.D.' or on other like terms; or
- (b) for payment against documents of title, except where such payment is due only after the goods are to become available for inspection.

We support the provisions of UCC 2-513(3), and recommend their adoption in the revised Act.<sup>92</sup>

The provisions of section 2-513(3) must, however, be read subject to UCC 2-512. This section provides that, where the contract requires payment before inspection, non-conformity of the goods does not excuse the buyer from so making payment, subject to the following two exceptions: namely,

- (a) where the non-conformity appears without inspection; or
- (b) where, despite tender of the required documents, the circumstances would justify injunction against honor under the provisions of section 5-114 of the Code.

As Comment 3 to section 2-512 explains, the first exception is based on common sense and normal commercial practice, and refers to a non-conformity that is evident in the mere process of taking delivery. We support UCC 2-512(1)(a) and need not pursue it further.

The rationale of the second exception, contained in UCC 2-512 (1)(b), is less self-evident, and requires more careful consideration. Section 5-114, referred to in paragraph (b), entitles the issuer of a letter of credit to honour a demand for payment, despite its customer's complaint that fraud, forgery or other defect not apparent on the face of the documents exists or has been committed, unless a court has enjoined such honour. Apparently, the provision reflects pre-Code case law.<sup>93</sup> According to Benjamin,<sup>94</sup> dicta in English cases are in accord with this provision.<sup>95</sup> It seems safe to assume that, what the buyer may do indirectly, he may

<sup>92</sup>See, Draft Bill, s. 7.12(4).

<sup>93</sup>For example, *Brown v. C. Rosenstein Co.* (1923), 200 N.Y.S. 491 (Sup. Ct.); *Williams Ice Cream Co. v. Chase Nat'l. Bank* (1924), 205 N.Y.S. 446 (App. Div.); see, also, Miller, "Problems and Patterns of the Letter of Credit", [1959] U. Ill. L.F. 162.

<sup>94</sup>*Benjamin's Sale of Goods* (1974), para. 2074. See, also, Sassoon, footnote 42 *supra*, pp. 407 *et seq.*

<sup>95</sup>*Société Metallurgique D'Aubrives & Villerupt v. British Bank for Foreign Trade* (1922), 11 Lloyd's Rep. 168 (K.B.D.), at p. 170; *Hamzeh Malas & Sons v. British Imex Industries Ltd.*, [1958] 2 Q.B. 127 (C.A.), at p. 130.

do directly; that is, he may refuse payment on the grounds of the seller's fraud. Ontario has no legislation directed specifically to letters of credit, and has no provision comparable to UCC 5-114. We recommend that the revised Act incorporate a provision comparable to UCC 2-512. However, the provision in the revised Act comparable to UCC 2-512(1)(b) should read "the seller has acted fraudulently".<sup>96</sup>

### 3. SUFFICIENCY AND FORM OF PAYMENT

The Ontario Sale of Goods Act contains no express provisions dealing with sufficiency and form of payment, and these questions continue to be governed by the common law. The common law rule is<sup>97</sup> that, unless otherwise agreed or established by usage of the trade or course of dealing between the parties, the price must be paid in legal tender of the realm. It goes without saying that this rule reflects a simpler mercantile age, and that little evidence will be needed to rebut its application at the present day. Express provisions relating to the sufficiency and form of payment are contained in UCC 2-511(2), which provides as follows:

2-511.(2) Tender of payment is sufficient when made by any means or in any manner current in the ordinary course of business unless the seller demands payment in legal tender and gives any extension of time reasonably necessary to procure it.

This subsection seems to us to conform to modern commercial dealings. Accordingly, we recommend that a provision equivalent to UCC 2-511(2) be incorporated in the revised Act.<sup>98</sup>

The question has, however, been raised<sup>99</sup> whether legislation of this nature would be *intra vires* the Province, given the federal Parliament's exclusive jurisdiction over currency and coinage, and bills and notes.<sup>100</sup> In our view, the adoption of a provision equivalent to UCC 2-511(2) in the revised Ontario Act would not trench upon fields of federal jurisdiction. The effect of such a provision would be simply to declare how the buyer's price obligations may be satisfied, and not to establish new forms of legal currency.

It is settled law<sup>101</sup> that, if the seller accepts payment by cheque or other type of instrument, the payment is only conditional and the original obligation will revive if the instrument is dishonoured. An express rule to this effect, involving payment by cheque, is now incorporated in UCC 2-511(3), and is inferentially assumed in section 37(1)(b) of the Ontario

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<sup>96</sup>See, Draft Bill, s. 7.11.

<sup>97</sup>*Benjamin's Sale of Goods* (1974), para. 693.

<sup>98</sup>See, Draft Bill, s. 7.10(2).

<sup>99</sup>Crawford, footnote 1 *supra*, at p. 70.

<sup>100</sup>*The British North America Act, 1867*, 30 & 31 Vict., c. 3 (U.K.), R.S.C. 1970, App. II, No. 5, s. 91.20, .14, .15, and .18.

<sup>101</sup>*Benjamin's Sale of Goods* (1974), para. 695.

Sale of Goods Act.<sup>102</sup> Assuming, as we do, that no conflict is involved with the federal *Bills of Exchange Act*,<sup>103</sup> we recommend the adoption of a provision similar to UCC 2-511(3) in the revised Ontario Act.<sup>104</sup> Although our recommended draft provision, following the Code, refers only to payment by cheque, it should be understood that the rule is not intended to be restricted to cases of payment by cheque. Where payment assumes the form of other types of instrument, the common law rules concerning conditional payment will continue to apply by virtue of the provision of our Draft Bill preserving the general principles of law and equity.<sup>105</sup>

#### 4. PLACE OF PAYMENT

Place of payment is another area in which there appears to be a theoretical conflict between the presumptive common law rule and accepted commercial practice. The common law rule is<sup>106</sup> that the debtor must seek out his creditor. The rule will, however, yield to the contrary intentions of the parties, as gathered from all the surrounding circumstances of the transaction. In the absence of such indications, Benjamin<sup>107</sup> suggests that the basic rule is displaced in commercial transactions in favour of a presumption that payment is to be made at the place where the creditor resided or carried on business at the time of the contract. Earlier in this chapter, we discussed UCC 2-310.<sup>108</sup> It will be noted that this section deals explicitly with both the time and place of payment where the parties are not dealing face to face. We have recommended adoption in the revised Act of a provision similar to UCC 2-310, insofar as it relates to time of payment. In our view, the provisions of UCC 2-310, as they apply to place of payment, should be sufficient to take care of the apparently infrequent occasions when the question is likely to become an issue between the parties. Accordingly, we recommend their adoption in the revised Act.<sup>109</sup>

#### 5. LETTERS OF CREDIT

The documentary letter of credit is a commercial instrument that has been in use for more than a hundred years as a means of financing international business transactions. Its use is now also spreading to a wide variety of domestic, and not necessarily sales-oriented, transactions. As

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<sup>102</sup>Section 37(1)(b) provides as follows:

The seller of goods shall be deemed to be an 'unpaid seller' within the meaning of this Act, . . .

(b) when a bill of exchange or other negotiable instrument has been received as conditional payment and the condition on which it was received has not been fulfilled by reason of the dishonour of the instrument or otherwise.

<sup>103</sup>R.S.C. 1970, c. B-5, as amended.

<sup>104</sup>See, Draft Bill, s. 7.10(3).

<sup>105</sup>See, Draft Bill, s. 3.4(1).

<sup>106</sup>*E. Leonard & Sons v. Cushing Bros. Co. Ltd.* (1914), 30 O.L.R. 646 (C.A.); *Re Sovereign Mitt Glove and Robe & Co. v. Cameron* (1915), 35 O.L.R. 143 (H.C.J.); *Collins v. Wilson* (1922), 70 D.L.R. 642 (Sask. C.A.).

<sup>107</sup>*Benjamin's Sale of Goods* (1974), para. 705, at p. 314.

<sup>108</sup>*Supra*, this ch., sec. B.1.

<sup>109</sup>See, Draft Bill, s. 5.8.

has been stated, its object is "to solve two problems that arise in most sales involving a substantial period of shipment: the problem of furnishing security and that of raising credit".<sup>110</sup> The wide use of documentary credits in international transactions has led to a need for uniformity.<sup>111</sup> As noted in an earlier chapter,<sup>112</sup> the International Chamber of Commerce has played a key role in promoting this objective. The Chamber, in 1933, first promulgated a code of Uniform Customs and Practice for Documentary Credits, a code known as the UCP. Revised versions of this code were issued in 1951 and 1962, and a further revision was completed in 1974.<sup>113</sup> The UCP has been enormously successful, and has been adopted by the bankers of 148 countries, including those of the U.S.A., the United Kingdom, Canada, and most other Commonwealth jurisdictions.

For reasons that are not entirely clear,<sup>114</sup> the sponsors of the *Uniform Commercial Code* decided to include a separate Article, Article 5, to deal with documentary letters of credit. Of all the Articles in the Code, Article 5 is unique: it does not purport to supplant any existing comprehensive statute or series of statutes, but codifies, albeit only partially, an area previously almost untouched by the hand of the legislator.<sup>115</sup> Article 5 is not simply an American replica of the UCP, but appears to differ from it in significant respects.<sup>116</sup> Our terms of reference do not include the law of letters of credit, and we offer no opinion on the desirability of codifying this branch of the law, or on the comparative merits of Article 5 and the UCP. It would be fair to say, however, that we have detected no evidence that the law of letters of credit is in need of reform, or that the business community is dissatisfied with its present informal status. This conclusion is supported, at least to some extent, by the negligible amount of Canadian jurisprudence on the subject.<sup>117</sup>

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<sup>110</sup>*Benjamin's Sale of Goods* (1974), para. 2001. Compare, Joseph, "Letters of Credit: the Developing Concepts and Financing Function" (1977), 94 *Bank. L.J.* 816.

<sup>111</sup>Compare, McCrohan, "The Letter of Credit in a Changing Competitive Environment" (1977), 9 *J. Mar. L. & Comm.* 151, contending that international use is declining.

<sup>112</sup>*Supra*, ch. 2, sec. 5(d).

<sup>113</sup>See, Schmitthoff, *The Export Trade* (6th ed., 1975), pp. 216-17; and compare, *Benjamin's Sale of Goods* (1974), para. 2008.

<sup>114</sup>Compare, NYLRC Study, ch. 5, footnote 52, *supra*, Vol. 3, p. (1575).

<sup>115</sup>*Ibid.*

<sup>116</sup>See, Professor Schlesinger's trenchant criticisms of the pre-1955 version of Article 5 in the NYLRC Study, ch. 5, footnote 52, *supra*, Vol. 3, at pp. (1576) *et seq.*

<sup>117</sup>The complete list of Canadian cases on letters of credit seems to be as follows: *Davis O'Brien Lumber Co. v. Bank of Montreal*, [1951] 3 D.L.R. 536 (N.B.C.A.); *Sovereign Bank v. Bellhouse Dillon & Co.* (1911), 23 Que. K.B. 413 (C.A.); *Jacques-Cartier Bank v. R.* (1895), 25 S.C.R. 84; *Rolland v. Caisse D'Economie Notre-Dame de Que.* (1895), 24 S.C.R. 405; *Bank of Toronto v. Ansell* (1875), 7 R.L.O.S. 262 (C.A.); *White v. Hunter* (1841), 1 U.C.Q.B. 452 (C.A.); *Gissing v. Hopper* (1843), 6 O.S. 505 (C.A.); *Co-operative Fisheries Ltd. v. Canadian Imperial Bank of Commerce* (1969), 7 D.L.R. (3d) 610 (Sask. Q.B.); and *Rattner and Penneys v. Mercantile Bank of Canada* (Ont. H.C.J.), (decision of Holland, J., dated August, 1977, not yet reported).

While, as stated, we express no views as to the need for a comprehensive review of the law of letters of credit, some aspects of the general area have a direct impact upon sales law and do, in our view, merit specific attention. We have been particularly concerned with UCC 2-325, which contains the only reference in Article 2 to documentary letters of credit. This section provides as follows:

2-325(1) Failure of the buyer seasonably to furnish an agreed letter of credit is a breach of the contract for sale.

(2) The delivery to seller of a proper letter of credit suspends the buyer's obligation to pay. If the letter of credit is dishonored, the seller may on seasonable notification to the buyer require payment directly from him.

(3) Unless otherwise agreed the term 'letter of credit' or 'banker's credit' in a contract for sale means an irrevocable credit issued by a financing agency of good repute and, where the shipment is overseas, of good international repute. The term 'confirmed credit' means that the credit must also carry the direct obligation of such an agency which does business in the seller's financial market.

Subsections (1) and (2) conform to existing law and are unobjectionable.<sup>118</sup> The meaning of "letter of credit" in subsection (3) differs from the UCP provisions, which only require a clear statement as to whether the credit is revocable or irrevocable and, in the absence of a contrary indication, treat it as revocable.<sup>119</sup> However, the precedent of the UCP is not too persuasive. The UCP is concerned with the obligations of the issuing bank, and not with the obligations assumed by the buyer under the terms of the contract of sale. Since a documentary credit is designed to protect the seller's interests, a presumption of irrevocability appears to be more consistent with the parties' intentions, and is supported by judicial authority.<sup>120</sup> UCC 2-325(3) further requires that the letter of credit must be issued by a financing agency of good repute. This requirement is again consistent with the purpose of the documentary credit. The definition of "confirmed credit" in subsection (3) corresponds with the definition in the UCP,<sup>121</sup> save that the latter contains no requirement that the confirming bank must carry on business in the seller's financial market. Again, however, the Code provision would appear to be in accord with commercial understanding.<sup>122</sup>

Our overall conclusion is that all three subsections of UCC 2-325 are clearly related to the law of sales and would be useful additions to the revised Ontario Act. Accordingly, we recommend that the revised Act incorporate a provision comparable to UCC 2-325.<sup>123</sup> In our view the

<sup>118</sup>Crawford, footnote 1 *supra*, at pp. 76-77. Compare NYLRC Study, ch. 5, footnote 52, *supra*, pp. (434)-(435).

<sup>119</sup>Article 1.

<sup>120</sup>*Benjamin's Sale of Goods* (1974), para. 2034, citing *Giddens v. Anglo-African Produce Co. Ltd.* (1923), 14 Lloyd's Rep. 230 (K.B.D.).

<sup>121</sup>Article 3.

<sup>122</sup>NYLRC Study, ch. 5, footnote 52, *supra*, p. (436).

<sup>123</sup>See, Draft Bill, s. 5.25.

enactment of such a provision falls within the provincial competence. We know of no conflicting federal provisions.

## 6. RIGHTS OF FINANCING AGENCY

Section 37(2) of the Ontario Sale of Goods Act provides that, for purposes of Part IV of the Act dealing with the rights of an unpaid seller against goods, " 'seller' includes a person who is in the position of a seller, as for instance an agent of the seller to whom the bill of lading has been endorsed . . .". UCC 2-707 contains a similar, but modernized, version of section 37(2). The Code provision is superior to section 37(2) insofar as it makes it clear that a "person in the position of a seller" includes a person who holds, "a security interest or other right in goods similar to that of a seller". We are of the view that the revised Act should adopt a provision similar to UCC 2-707, and so recommend.<sup>124</sup>

The Code contains a further, related, and to some extent overlapping, provision. UCC 2-506(1) states as follows:

2-506.(1) A financing agency by paying or purchasing for value a draft which relates to a shipment of goods acquires to the extent of the payment or purchase and in addition to its own rights under the draft and any document of title securing it any rights of the shipper in the goods including the right to stop delivery and the shipper's right to have the draft honored by the buyer.

In our view, this provision also reflects existing Ontario law. Since we have recommended adoption of the related sections in this part of Article 2, we also recommend, for the sake of consistency, adoption of UCC 2-506(1).<sup>125</sup>

The provisions of UCC 2-506(2) also merit reference. Subsection (2) of section 2-506 provides as follows:

2-506.(2) The right to reimbursement of a financing agency which has in good faith honored or purchased the draft under commitment to or authority from the buyer is not impaired by subsequent discovery of defects with reference to any relevant document which was apparently regular on its face.

*The Sale of Goods Act* contains no corresponding provision, no doubt because UCC 2-506(2) is concerned with the relationship between the buyer and *his* financing agency. However, there is nothing unusual about UCC 2-506(2). It appears merely to reflect the common law position,<sup>126</sup> albeit in a slightly wider context, with respect to the duties of a banker

<sup>124</sup>See, Draft Bill, s. 9.6.

<sup>125</sup>See, Draft Bill, s. 7.5(1). We have substituted "bill of exchange", the term sanctioned in the *Bills of Exchange Act*, R.S.C. 1970, c. B-5, ss. 2, 17, for the term "draft", used in UCC 2-506 and used interchangeably with bill of exchange in UCC 3-104(2)(a). Our draft provision also substitutes the word "seller" for "shipper" in UCC 2-506(1).

<sup>126</sup>See, *Benjamin's Sale of Goods* (1974), paras. 2062-64.

under a documentary credit to examine documents presented to him, and to reflect, also, Articles 7 and 9 of the Uniform Customs and Practice for Documentary Credits. Accordingly, for the sake of consistency, we also recommend adoption of subsection (2) of UCC 2-506.<sup>127</sup>

We have considered whether our draft provision should include a reference to promissory notes as well, but have decided against such a reference. Sellers do not ship valuable goods over long distances on the basis of a buyer's promissory note. Moreover, there is no evidence that they are likely to do so in the foreseeable future. For a long time, it was commercial practice (both in overseas and, to a lesser extent, domestic shipments) for a seller concerned to ensure payment for his goods to draw a bill of exchange at the time of shipment on the buyer or a bank with which the buyer had established a line of credit. The seller attached this bill to the bill of lading and, thus secured, the bill of exchange would be forwarded to the buyer for his acceptance, or entrusted to the seller's bank or other agent for the same purpose. This practice is reflected in section 20(3) of *The Sale of Goods Act*.<sup>128</sup> Nowadays, this sequence of events is largely augmented or replaced by the use of a letter of credit issued by the buyer's bank. This practice substitutes the bank's credit for that of the buyer, and thus decreases the seller's risk. For these reasons we feel that it is proper to omit a reference to promissory notes.<sup>129</sup>

In recommending adoption of a provision similar to UCC 2-506, we have considered two constitutional issues. The first issue is whether, in legislating in respect of the rights of a financing agency, the Province would be dealing with banking, an exclusive head of federal legislative authority under section 91.15 of *The British North America Act, 1867*.<sup>130</sup> This issue arises because our recommended definition of "financing agency"<sup>131</sup> includes a "bank". While it is true that Parliament's power in respect of banking has been interpreted broadly,<sup>132</sup> the courts have not given this federal power a very large role in terms of precluding provincial legislation.<sup>133</sup> Our recommended draft provision does not give rise to any appar-

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<sup>127</sup>See, Draft Bill, s. 7.5(2).

<sup>128</sup>Compare, *Cahn and Mayer v. Pockett's Bristol Channel Steam Packet Co. Ltd.* [1899] 1 Q.B. 643 (C.A.).

<sup>129</sup>For a lucid exposition of current financing techniques in this area, see Harfield, *Bank Credits and Acceptances* (5th ed., 1974).

<sup>130</sup>30 & 31 Vict., c. 3 (U.K.), R.S.C. 1970, App. II, No. 5.

<sup>131</sup>See, Draft Bill, s. 1.1(1)13.

<sup>132</sup>For example, *Tennant v. Union Bank of Canada*, [1894] A.C. 31 (P.C.), at p. 46.

<sup>133</sup>This is evident in decisions that have upheld provincial legislation dealing with deposit taking and lending institutions, such as credit unions, some of the activities of which are similar to those of banks: see, *In re Dominion Trust Co.*, [1918] 3 W.W.R. 1023 (B.C.S.C.); *Re Bergethaller Waisenamt*, [1949] 4 D.L.R. 769 (Man. C.A.); *La Caisse Populaire Notre Dame Limitee v. Moyen* (1967), 61 D.L.R. (2d) 118 (Sask. Q.B.); but compare the dissenting opinion of Hall, J., (Spence, J., concurring) in *Breckenridge Speedway Ltd. v. The Queen* (1969), 9 D.L.R.(3d) 142 (S.C.C.). It is also apparent from a series of

ent conflict with the *Bank Act*,<sup>134</sup> or with other potentially applicable federal banking legislation. Moreover, although our provision may affect banks in their capacity as financing agencies, this will clearly occur only in the context of sale of goods legislation. The Commission has concluded, therefore, that the true nature and character of the recommended provision should properly be viewed as being in relation to property and civil rights, a head of exclusive provincial legislative authority under section 92.13. The second constitutional issue is whether our recommended provision may be impugned on the ground that it is legislation in respect of bills of exchange, which are exclusively a federal matter under section 91.18 of *The British North America Act*. In our opinion, our provision does not interfere with the rights of a holder of a bill of exchange. Instead, it simply recognizes the existence of those rights, and gives a financing agency holding a bill of exchange additional rights in the nature of those that a seller enjoys in a sale of goods transaction. The Commission has concluded, therefore, that this provision may properly be characterized as relating to the sale of goods, an activity in respect of which a province may properly legislate under section 92.13. However, to put the matter beyond doubt, we have provided in our Draft Bill<sup>135</sup> that nothing contained therein shall affect any right of a holder in due course of a bill, note or cheque within the meaning of the *Bills of Exchange Act*.<sup>136</sup>

Finally, we are aware that the bill of exchange and other traditional payment instruments may eventually be replaced by electronic forms of transfer and payment authorizations. This development may make it desirable to broaden the scope of the recommended provision in the revised Act, and of references to payment instruments in other parts of the Act. These changes are, however, still in course of evolution.<sup>137</sup> They will, in any event, involve far-reaching legislative changes in the area of banking and negotiable instruments. In our view, it would be premature at this stage to attempt to anticipate necessary corresponding amendments to the revised Sale of Goods Act.

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decisions holding banks subject to such general provincial statutes as those governing the following: (a) mechanics' liens: *Fonthill Lumber Co. v. Bank of Montreal* (1959), 19 D.L.R. (2d) 618 (Ont. C.A.); *Canadian Imperial Bank of Commerce v. T. McAvity & Sons, Ltd.*, [1959] S.C.R. 478; *John M. M. Troup Ltd. v. Royal Bank of Canada*, [1962] S.C.R. 487; (b) seizure for outstanding taxes: *Brantford v. Imperial Bank*, [1930] 4 D.L.R. 658 (Ont. C.A.); (c) landlords' rights of distraint: *Re Newmarket Lumber Co. Ltd.*, [1951] D.L.R. 720 (Ont. H.C.J.); (d) inspection of records for the purposes of civil litigation: *Sommers v. Sturdy* (1957), 10 D.L.R. (2d) 269 (B.C.C.A.). When this result has been obtained, it has always been in the absence of any valid and paramount federal legislation that might displace the relevant provincial legislation so far as banking is concerned.

<sup>134</sup>R.S.C. 1970, c. B-1.

<sup>135</sup>See, Draft Bill, s. 3.4(2). It will be noted that other sections of the Draft Bill, for example, s. 7.13, also refer to matters involving bills of exchange.

<sup>136</sup>R.S.C. 1970, c. B-5.

<sup>137</sup>Compare, *Branching Out*, Report of the Canadian Computer-Communications Task Force (Dept. of Communications, Ottawa, May, 1972), Vol. 2, ch. 3.

### RECOMMENDATIONS

The Commission makes the following recommendations:

1. The revised Act should strive for greater clarity in the use of the term "delivery" and its various derivatives.
2. The revised Act, following UCC 2-309(1), should make it clear that, where the contract itself specifies no time for delivery, the seller's obligation to deliver the goods within a reasonable time is not restricted to cases where the seller is to send the goods to the buyer, but applies to all forms of delivery.
3. Pursuant to our earlier recommendation eschewing the *a priori* classification of contractual terms, and subject to further recommendations contained in chapter 17, the revised Act should not adopt a rule making time of delivery of the goods *prima facie* an essential term of the contract, or treating a breach with respect to time of delivery as amounting *prima facie* to a substantial breach of the contract.
4. Since neither section 28(1) of the existing Sale of Goods Act nor UCC 2-308 deals with the questions, the revised Act should specify, in accordance with the presumptive rules set out in section 5.6 of our Draft Bill, the place of delivery where the seller has more than one place of business or residence or where, in a contract of sale of identified or unascertained goods, the parties knew at the time of contracting that the goods were located or were to be drawn from bulk or manufactured or produced at a particular place.
5. The revised Act should incorporate a provision similar to UCC 2-503(4) with respect to the seller's obligations where the goods are in the possession of a third person.
6. Section 28(2) of *The Personal Property Security Act* dealing with the perfection of a security interest in goods held by a bailee, other than a bailee who has issued a negotiable document of title, should be amended to harmonize with the provision in the revised Act similar to UCC 2-503(4)(b) and with sections 20 and 21 of *The Warehouse Receipts Act*, which do not require attornment by the bailee to the buyer.
7. A provision similar to UCC 2-504 dealing with the seller's obligations in the case of a sale involving shipment should be adopted in the revised Act in preference to section 31 of the existing Sale of Goods Act. However, the reference in the concluding sentence of UCC 2-504 to the consequences of the seller's failure to notify the buyer of the shipment or to make a proper contract of transportation should be omitted; breach of the seller's shipment obligations should be governed by the same remedial rules applicable to other breaches by the seller.

8. The seller's reservation of a right of disposal in goods after shipment should be designated in the revised Act as the reservation of a security interest. Accordingly, a provision comparable to UCC 2-505 should be adopted in the revised Act in place of section 20(2) of the existing Act, subject to the elimination of the distinction in the Code provision between "security interest" and "possession . . . as security".
9. In light of the above recommendation, consideration should be given to amending section 3(2) of *The Personal Property Security Act* so as to make it correspond to UCC 9-113.
10. The revised Sale of Goods Act should incorporate a definition of common trade terms. The definitions contained in sections 2-319 to 2-323 of the *Uniform Commercial Code* should be adopted in preference to the *Incoterms* promulgated by the International Chamber of Commerce.
11. No attempt should be made at this time to codify the law relating to the rights and obligations of sellers and buyers under a container transport of goods.
12. Pursuant to our earlier recommendation eschewing the *a priori* classification of contractual terms, and subject to further recommendations contained in chapter 16, the revised Sale of Goods Act should not adopt a rule characterizing the importance of terms with respect to time of payment or characterizing the *prima facie* gravity of a breach thereof.
13. The revised Act should adopt, in place of the concurrent payment and delivery rule contained in section 27 of the existing Sale of Goods Act, a provision comparable to UCC 2-310, insofar as the Code provision relates to time of payment.
14. The revised Act should incorporate provisions relating to payment before inspection of the goods similar to those contained in UCC 2-513(3) and UCC 2-512. The words "the seller has acted fraudulently" should, however, be substituted for the existing language of UCC 2-512(1)(b).
15. The revised Act should adopt an express provision, similar to UCC 2-511(2), to the effect that tender of payment is sufficient when made by any means or in any manner current in the ordinary course of business, unless the seller demands payment in legal tender and gives any extension of time reasonably necessary to procure it.
16. The revised Act should adopt an express provision, similar to UCC 2-511(3), to the effect that payment by cheque is conditional and may be defeated as between the parties if the cheque is dishonoured.
17. Provisions similar to UCC 2-310, as they relate to place of payment, should be adopted in the revised Ontario Sale of Goods Act.

18. No opinion is expressed concerning the desirability of codifying the law relating to letters of credit or the comparative merits of Article 5 of the *Uniform Commercial Code* and the Uniform Customs and Practice for Documentary Credits promulgated by the International Chamber of Commerce; the revised Act should, however, incorporate a provision similar to UCC 2-325.
19. The revised Act should adopt provisions comparable to UCC 2-707 dealing with a "person in the position of a seller" and UCC 2-506 dealing with rights of a financing agency, in place of section 37(2) of the existing Sale of Goods Act.



## CHAPTER 15

### FRUSTRATION IN CONTRACTS OF SALE

#### 1. INTRODUCTION

Like the law of mistake, the rules governing the frustration of agreements belong to one of the most difficult branches of contract law.<sup>1</sup> The relatively small number of Canadian sales cases involving frustration issues and the infrequency with which the parties themselves may encounter the problem in periods of national and international stability<sup>2</sup> mask the legal difficulties. In an environment of intense inflation and rapidly changing economic and political conditions, the parties are often faced with contingencies not foreseen at the time of contracting or which undermine their common assumptions. *Force majeure* clauses are a regular feature in well drafted contracts,<sup>3</sup> and the parties may seek to protect themselves against future imponderables by the insertion of other appropriate clauses in their contracts. These drafting devices may diminish the need for clear rules; they do not replace them.

With the exception of section 8, *The Sale of Goods Act* does not purport to codify the law of frustration in its relation to contracts of sale. Cases falling outside the provisions of section 8 continue to be governed by common law principles.<sup>4</sup> The common law position, though much litigated in this century in the United Kingdom, is far from clear, and both the theory of frustration and its scope as a defence remain unsettled. There is, therefore, much to be said for an attempt to clarify the present law. As will be seen, the *Uniform Commercial Code* contains a substantial number of provisions which, while disclaiming any pretence at a comprehensive statement, do clarify and improve the existing position in important respects in so far as contracts of sale are concerned. For a number of reasons, we support a similar approach in the revised Act to that adopted in the Code. The desirability of a general restatement of frustration principles should, we believe, be left for future consideration as part of our proposed Law of Contract Amendment Project.

#### 2. THE SALE OF GOODS ACT, SECTION 8

Section 8 of *The Sale of Goods Act* deals with one aspect of the law of frustration in relation to a contract of sale; that is, the loss of specific goods. The section provides as follows:

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<sup>1</sup>For a general discussion of the topic of frustration, see McCamus, "The Doctrine of Frustration in the Law of Sales", Research Paper No. II.7.

<sup>2</sup>Approximately 85% of the respondents to the CMA Questionnaire (Research Paper No. I.1, Q. 51) stated that frustration problems arose rarely or never, and represented not more than 0.5% of total sales. It should be noted, however, that the questionnaire was answered before the 1973-74 oil crisis and the subsequent dislocation of the economies of many Western countries.

<sup>3</sup>See, McCamus, footnote 1 *supra*, at p. 5b.

<sup>4</sup>Summarized in McCamus, footnote 1 *supra*, at pp. 6-38. See, also, *Benjamin's Sale of Goods* (1974), paras. 424-49.

8. Where there is an agreement to sell specific goods and subsequently the goods without any fault of the seller or buyer perish before the risk passes to the buyer, the agreement is thereby avoided.

The effect of section 8 is to discharge the seller's obligation to deliver and the buyer's obligation to pay the price. The section should be read in conjunction with its companion provision, section 7,<sup>5</sup> which applies similar principles to determine the effect on the contract of the parties' mistaken assumption with respect to the existence of the goods. As was noted in an earlier chapter,<sup>6</sup> section 7 raises problems of construction. This is also the case with section 8. The section is, moreover, seriously incomplete. We turn now to consider the deficiencies of section 8.<sup>7</sup>

First, section 8 deals only with the loss of "specific" goods. It is not clear whether the term "specific" is to be interpreted as referring solely to goods in existence at the time of making the contract. The Act defines "specific goods" in section 1(1)(m) as "goods identified and agreed upon at the time the contract of sale is made". In *Howell v. Coupland*,<sup>8</sup> however, a seller was excused from a contract of sale of potatoes to be grown on his land when the crop failed. This case, decided before the enactment of the *Sale of Goods Act, 1893*, and other similar decisions, have raised the possibility of the application of section 8 to "quasi-specific goods". The law has not, however, developed.<sup>9</sup>

Secondly, it will be noted that section 8 of *The Sale of Goods Act* only applies where the goods "perish". In chapter 5 of this Report, in the context of mistake, we considered<sup>10</sup> the question when goods have "perished" within the meaning of section 7 of the Act. The term "perish" raises similar problems of interpretation in the context of section 8. For example, it is difficult to determine what degree of deterioration of the subject matter will bring the section into operation. There is some authority,<sup>11</sup> disputed though it is,<sup>12</sup> that the concept of perishment includes deterioration that alters, but does not destroy, the goods. Similarly, the concept

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<sup>5</sup>Section 7 reads as follows:

Where there is a contract for the sale of specific goods and the goods without the knowledge of the seller have perished at the time the contract is made, the contract is void.

<sup>6</sup>*Supra*, ch. 5, sec. 5(a).

<sup>7</sup>See, McCamus, footnote 1 *supra*, at pp. 42 *et seq.*

<sup>8</sup>(1876), 1 Q.B.D. 258 (C.A.). See, also, *In Re Badische Co. Ltd.*, [1921] 2 Ch. 331, and cases cited by Sutton, *The Law of Sale of Goods in Australia and New Zealand* (2nd rev. ed., 1974), at p. 83.

<sup>9</sup>In *In re Wait*, [1927] 1 Ch. 606 (C.A.), at p. 630, Atkin, L.J., said that these cases could be explained either as sales dependent on a contingency that fails, or as covered by a rule of common law not inconsistent with the Act.

<sup>10</sup>*Supra*, ch. 5, sec. 5(a).

<sup>11</sup>*Rendell v. Turnbull & Co.* (1908), 27 N.Z.L.R. 1067 (S.C.). See, also, Esher, M.R., in *Asfar & Co. v. Blundell*, [1896] 1 Q.B. 123 (C.A.), at p. 127; Atiyah, *The Sale of Goods* (5th ed., 1975), at pp. 46-47; Sutton, footnote 8 *supra*, at p. 87.

<sup>12</sup>*Horn v. Minister of Food*, [1948] 2 All E.R. 1036 (K.B.).

of perishment causes difficulty in indivisible contracts<sup>13</sup> where part of the subject matter of the contract is destroyed. There is authority<sup>14</sup> that partial destruction will result in frustration of an indivisible contract, with the result that, even though the buyer is willing to take the remaining goods, he cannot force the seller to deliver.

Thirdly, it is not clear to what extent "fault" includes loss due to negligence.<sup>15</sup> Section 1(1)(f) of *The Sale of Goods Act* defines "fault" to mean "a wrongful act or default". This definition is wide enough to embrace negligent conduct, and such a reading would be consistent with the rule applied in the case of self-induced frustration. Still, a small amendment to the definition would put the point beyond doubt.

Fourthly, difficulties are created by the restriction of section 8 to an "agreement to sell". By virtue of section 2(3) of *The Sale of Goods Act*,<sup>16</sup> there is an agreement to sell where there has been no transfer of property in the goods to the buyer, but where such transfer is to take place at a future time or subject to some condition to be fulfilled thereafter. It seems clear, therefore, that section 8 has no application to contracts of sale where property or title has passed to the buyer. Yet, where title has passed, risk may nevertheless remain with the seller by agreement, or control of the goods may not have passed to the buyer. In the latter case, it is true that the line between frustration concepts and the seller's obligation to deliver the goods blurs. Nevertheless, it may well be argued that the doctrine of frustration should apply in the situations discussed above, notwithstanding that title may have passed to the buyer.

Fifthly, similar difficulties arise because section 8 is restricted to cases where goods perish "before the risk passes to the buyer". The section will not apply, therefore, where risk of loss has been assumed by the buyer, even though property in and possession of the goods remain with the seller. Indeed, there might be a difficulty in applying the concept of

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<sup>13</sup>No difficulty is encountered if the seller's obligation with respect to the destroyed goods is severable. The severable portion of the contract relating to the goods still in existence is enforceable; that portion that concerns the destroyed goods is discharged.

<sup>14</sup>*Barrow, Lane & Ballard Ltd. v. Phillip Phillips & Co. Ltd.*, [1929] 1 K.B. 574. *Lovatt v. Hamilton* (1839), 5 M. & W. 639, 151 E.R. 271 (Exch.). Compare, *obiter dicta* in *Howell v. Coupland*, footnote 8 *supra*, and *H. R. & S. Sainsbury Ltd. v. Street*, [1972] 3 All E.R. 1127 (Q.B.D.). The result is that the buyer cannot compel delivery of the remaining goods even if he is willing to pay the full price, and even if the quantity destroyed is small: Sutton, footnote 8 *supra*, at p. 88.

<sup>15</sup>The point was expressly left open in *Joseph Constantine Steamship Line Ltd. v. Imperial Smelting Corp. Ltd.*, [1942] A.C. 154 (H.L.). For support for the view that negligence precludes operation of the doctrine, see *In re Arthur, Arthur v. Wynn* (1880), 14 Ch. D. 603; *Lebeaupin v. Richard Crispin & Co.*, [1920] 2 K.B. 714.

<sup>16</sup>Section 2(3) provides as follows:

(3) Where under a contract of sale the property in goods is transferred from the seller to the buyer, the contract is called a sale, but, where the transfer of the property in the goods is to take place at a future time or subject to some condition thereafter to be fulfilled, the contract is called an agreement to sell.

frustration to this situation: to discharge the seller from his obligation to deliver, on the ground of frustration, would also discharge the buyer from his obligation to pay the price, and this would conflict with the term of the contract placing the risk of loss on the buyer.<sup>17</sup> Professor Glanville Williams<sup>18</sup> would resolve this dilemma by applying frustration only to the obligation of the seller to deliver and not to the contract as a whole.

Sixthly, section 8 contains no reference to the relevance of foreseeability. A literal application of the section would lead to the conclusion, contrary at least to one line of frustration theory,<sup>19</sup> that the seller is excused from non-performance, even though he could reasonably foresee a substantial risk of loss of or damage to the goods.

Apart from these constructional points, section 8 is open to the further objection of serious incompleteness. The section fails to deal with accepted forms of frustration, other than those where specific goods have perished. For example, it omits any reference to impossibility with reference to the designated means of delivery, illegality, or frustration of purpose.<sup>20</sup> Such cases are left to the common law for resolution. Again,<sup>21</sup> there would appear to be no justification for the distinction drawn by the section between specific and unascertained goods, if one accepts, as we do, that frustration doctrines can apply just as readily to agreed or assumed sources of supply as to goods identified at the time of the formation of the contract. The courts have applied common law frustration concepts where the contractual source of supply fails,<sup>22</sup> but have not extended this analysis to the area of so-called "economic frustration"; that is, situations where alternative sources of supply, or performance generally, have become prohibitively expensive or otherwise burdensome.<sup>23</sup> As we shall see, the Code provisions, while not exhaustive, cover many more situations than does the Act. Before turning to the Code provisions, however, we think it appropriate to make brief reference to the provisions of the *Uniform Sales Act*.

<sup>17</sup>Hence, the risk of loss may be on the seller: Atiyah, *The Sale of Goods* (5th ed., 1975), at p. 171.

<sup>18</sup>Williams, *The Law Reform (Frustrated Contracts) Act 1943* (1944), at pp. 82-83. Sealy, "Risk in the Sale of Goods" (1972 B), 31 Camb. L.J. 225, at p. 237, puts forth the alternative suggestion that the buyer in such a case implicitly "waives all claims and rights which arise from the non-performance by the seller of his obligations in so far as this is attributable to such loss or damage".

<sup>19</sup>See, for example, *Davis Contractors Ltd. v. Fareham U.D.C.*, [1956] A.C. 696 (H.L.), at p. 728; *Canadian Government Merchant Marine v. Canadian Trading Co.* (1922), 64 S.C.R. 106, 123; *Ziger v. Shiffer and Hillman Co. Ltd.*, [1933] O.W.N. 293, [1933] 2 D.L.R. 691 (C.A.); *Restatement of the Law of Contracts*, s. 456.

<sup>20</sup>See, McCamus, footnote 1 *supra*, at p. 48.

<sup>21</sup>*Ibid.*, at pp. 55-56.

<sup>22</sup>See, *In Re Badische Co. Ltd.*, footnote 8 *supra* (contract to supply goods known only to be available in Germany discharged by war). Compare, *Monkland v. Jack Barclay Ltd.*, [1951] 2 K.B. 252 (C.A.).

<sup>23</sup>*Tsakiroglou & Co. Ltd. v. Noble Thorl G.m.b.H.*, [1962] A.C. 93 (H.L.) (closure of Suez Canal did not create frustration). See, also, *Ocean Tramp Tankers Corp. v. V/O Sovfracht (The Eugenia)*, [1964] 2 Q.B. 226 (C.A.), (closure of Suez did not discharge shipowner from charterparty to carry goods from Genoa to India).

### 3. UNIFORM SALES ACT, SECTION 8

Section 7 and subsection (1) of section 8 of the *Uniform Sales Act* were cast in the same terms as sections 7 and 8 of the Ontario Sale of Goods Act, respectively. Subsection (2) of section 8 was new, however, and gave the buyer the option to avoid the contract, or to acquire the remaining goods or the undeteriorated portion of them, where part of the goods had perished, or the whole or a material part of the goods had so deteriorated as to be materially changed in character. However, the value of this option was greatly weakened by the requirement that the buyer had to pay the full price for the remaining goods if the contract was indivisible.<sup>24</sup> Obviously, this gave him little incentive to exercise the option.

### 4. CODE PROVISIONS

Sections 2-613 to 2-616 of the *Uniform Commercial Code* contain the important provisions of Article 2 on the definition of frustrating events and their impact on the parties' rights and duties. These provisions, though falling short of a complete codification of the rules of frustration as applied to contracts for the sale of goods, are much more extensive in their coverage than section 8 of the Ontario Sale of Goods Act. We think it desirable to deal generally with the major features of these provisions before turning our attention to their more detailed discussion.

Section 2-613 deals with goods identified to the contract that suffer "casualty" before the risk of loss has passed to the buyer. This section reproduces, with an important change, the provisions in section 8 of the *Uniform Sales Act*. Where the loss is total, the contract is avoided; where partial loss or deterioration results, the buyer has the option to avoid the contract or, unlike the position under the *Uniform Sales Act*, to accept the contract with an allowance for the deficiency.

Subsection (1) of section 2-614 deals with a failure of the agreed means of carriage or delivery. It provides that, if a commercially reasonable substitute is available, such substitute performance must be tendered and accepted. Presumably, although this is not explicitly stated, the absence of such a substitute will result in avoidance of the contract. Subsection (2) is concerned with failure of the means or manner of payment due to government regulation. Where, in such circumstances, the seller has not delivered the goods, he may withhold them, unless the buyer provides a substantially equivalent means of payment. If delivery has already occurred, the buyer is permitted to keep the goods and pay as allowed by the government regulation, if the regulation is not discriminatory, oppressive or predatory.

In terms of Anglo-Canadian law, UCC 2-615 contains the Code's most radical provisions. Arguably, the section substantially expands the basis and scope of the doctrine of frustration as traditionally, but not

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<sup>24</sup>McCamus, footnote 1 *supra*, at pp. 62-63, citing *Williston on Sales* (Rev. ed., 1948), sec. 164.

consistently, applied in our law. Paragraph (a)<sup>25</sup> of UCC 2-615 provides, *inter alia*, that a seller who complies with the balance of the section is not in breach where the occurrence of a contingency "the non-occurrence of which was a basic assumption on which the contract was based", results in a delay in delivery or non-delivery in whole or in part. Paragraph (b) requires the seller to allocate in a fair and reasonable manner his remaining "production" among his customers, or, if he wishes, among his regular customers. Paragraph (c) requires him to give notice of the delay or non-delivery, and of allocation to the buyer. Apparently, the seller may modify his obligations under this section only by undertaking *greater* responsibilities.

Section 2-616 deals with the buyer's rights upon receipt of notice under UCC 2-615(c) of delay or of an allocation justified under section 2-615. The buyer who receives the required notice may terminate the contract and discharge any unexecuted portion thereof, or may modify the contract by agreeing to accept the allocated amount. If, however, the contract is an instalment contract, a substantial impairment of value is required for the buyer to terminate. Silence by the buyer causes the contract to lapse in 30 days, and the protection afforded the buyer by the section cannot be altered by agreement, except insofar as the seller increases his obligations under section 2-615.

We support, in general, the provisions of UCC 2-613 to 2-616 and believe that, subject to the modifications discussed hereafter, they could usefully be incorporated in the revised Ontario Act. We proceed now to examine the Code provisions in greater detail.

#### (a) UCC 2-613

It will be recalled that we have already discussed UCC 2-613 in chapter 5 of this Report, in the context of section 7 of *The Sale of Goods Act*. In chapter 5, we recommended that the revised Act should adopt, in place of section 7 of the existing Act, a provision comparable to UCC 2-613 with respect to the effect on the contract of the parties' mistaken assumption as to the existence of the goods. In the context of our discussion of frustration, it will be convenient to set out, once again, the provisions of UCC 2-613, which read as follows:

2-613. Where the contract requires for its performance goods identified when the contract is made, and the goods suffer casualty without fault of either party before the risk of loss passes to the buyer, or in a proper case under a 'no arrival, no sale' term (Section 2-324) then

- (a) if the loss is total the contract is avoided; and
- (b) if the loss is partial or the goods have so deteriorated as no longer to conform to the contract the buyer may nevertheless demand inspection and at his option either treat the contract as

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<sup>25</sup>This paragraph is the statutory offspring of s. 454 of the *Restatement of the Law of Contracts*, and thus does not represent a major shift in the American statement of the doctrine.

avoided or accept the goods with due allowance from the contract price for the deterioration or the deficiency in quantity but without further right against the seller.

This section felicitously fuses the old provisions in sections 7 and 8 of the *Uniform Sales Act*. As has been previously noted, it improves on them, and *a fortiori* on the provisions of section 8 of the Ontario Act, insofar as it confers an option on the buyer to obtain the surviving or deteriorated goods with an abatement in the price. Further, in our view, the term "casualty" is more meaningful to express the applicability of the Code section to all forms of loss or damage affecting the goods, without regard to the extent or value of the loss or damage, and overcomes the difficulties inherent in the use of the word "perish" in our Sale of Goods Act. But the section also has its weaknesses and, in our view, could be improved or clarified in a number of respects. We therefore recommend adoption in the revised Act of a provision similar to UCC 2-613 with respect to casualty to identified goods, but subject to the following amendments.

First, the section should not be confined to "goods identified when the contract is made". This phraseology continues the present requirement of specific goods, with its attendant problems.<sup>26</sup> There appears to be no sufficient reason why the rule should not also apply where goods are subsequently identified to the contract with the consent of both parties. Accordingly, we recommend that the provision in the revised Act comparable to UCC 2-613 should apply to "goods identified when the contract is made or goods that have been subsequently identified to the contract with the consent of the buyer and the seller".<sup>27</sup>

Secondly, the application of the section should not be confined, as under section 8 of *The Sale of Goods Act*, to cases in which goods suffer casualty "before the risk" passes to the buyer. As Glanville Williams first suggested,<sup>28</sup> this linking of discharge of the seller to the location of risk is misconceived. Earlier in this chapter,<sup>29</sup> we discussed the difficulties that can arise where risk has passed to the buyer, but property in and possession of the goods remains with the seller. These difficulties may occur equally under UCC 2-613. The function of the rules governing passage of risk, which in Ontario are contained in section 21 of *The Sale of Goods Act*, is to determine which party to a contract bears the risk of loss of, or damage to, the goods. Section 21 does not, of itself, answer the question whether, where the goods have suffered casualty, the seller is discharged from his obligation to perform. That function is served by the doctrine of frustration. In our opinion, the question whether a seller should be discharged from his obligations should be wholly severed from the question of who bears the risk of loss at the time of casualty. Furthermore, the seller's right to be discharged, in whole or in part, from the performance of his obligations should not affect the buyer's obligation to pay the price if he has assumed the risk of loss. Accordingly, we recommend that

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<sup>26</sup>*Supra*, this ch., sec. 2.

<sup>27</sup>See, Draft Bill, s. 8.13(2)(a).

<sup>28</sup>*Supra*, footnote 18.

<sup>29</sup>*Supra*, this ch., sec. 2.

the application of the provision in the revised Act comparable to UCC 2-613 should not be restricted to cases where goods suffer casualty before risk of loss has passed to the buyer. This recommendation is subject to the qualification that the buyer should retain the right to compel partial performance, with due allowance, in the case of partial loss or destruction of the goods, where the risk of such casualty has not passed to him. Where the risk of casualty is with the buyer, he should also have the right to claim the remaining goods, but without an abatement in the price.<sup>30</sup> It follows from what we have said that the section in the revised Act comparable to UCC 2-613 should expressly provide that, in the case of casualty to goods, the seller's obligation is discharged, but the buyer is discharged from the obligation to pay the price only if the risk of such loss has not passed to the buyer.<sup>31</sup>

Thirdly, like its predecessors, section 2-613 appears to operate absolutely, without regard to the foreseeability of the casualty, or to any undertaking on the seller's part to assume liability for delivery in any event. To cover this contingency, it has been suggested to us<sup>32</sup> that the operation of the section be excluded where the promisor has special knowledge leading him to "anticipate" the casualty which he does not communicate to the buyer, even though he has reason to believe that the buyer does not possess the knowledge. A further suggestion is that the section should not apply where the seller assumes responsibility for the continued and unblemished existence of the goods. We think that both these factors can be accommodated by making it clear that the section applies "unless the circumstances indicate that either party has assumed a greater obligation". We therefore recommend that these words be added to the provision in the revised Act corresponding to UCC 2-613.<sup>33</sup> Any remaining lacunae will be picked up by the existing requirement in UCC 2-613 that both parties must be "without fault", and by the general requirement of good faith applicable throughout the revised Act.

Earlier in this chapter,<sup>34</sup> we indicated that it is unclear whether "fault", as used in section 8 of *The Sale of Goods Act*, includes loss due to negligence. Comment 1 to UCC 2-613 states that "'fault' is intended to include negligence and not merely wilful wrong". We are of the view that "fault" as used in the revised Act should include loss due to negligence, and accordingly recommend that the revised Act adopt the Code definition of "fault".<sup>35</sup>

While we do not favour retaining even an improved version of section 8 of the Ontario Act as an isolated provision governing one aspect of the rules of frustration, we support<sup>36</sup> a provision comparable to UCC 2-613 in the context of a larger group of frustration provisions. We ap-

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<sup>30</sup>See, Draft Bill, s. 8.13(1).

<sup>31</sup>*Ibid.*, s. 8.13(1)1.

<sup>32</sup>McCamus, footnote 1 *supra*, at p. 74.

<sup>33</sup>See, Draft Bill, s. 8.13(1), lines 6 and 7.

<sup>34</sup>*Supra*, sec. 2.

<sup>35</sup>See, Draft Bill, s. 1.1(1)12.

<sup>36</sup>Compare, NYLRC Study, ch. 5, footnote 52, *supra*, p. (679).

preciate that it may be contended that UCC 2-613 deals with but one instance of the application of the broader rule codified in UCC 2-615, and that no good purpose would be served by including such a provision in the revised Act. We are not, however, persuaded by this line of reasoning, and favour a specific provision along the lines of UCC 2-613 on two grounds. First, it would set forth expressly the buyer's rights in the event of the seller's discharge, whereas such a provision is lacking at present in section 2-615. Secondly, it would make it clear that casualty to identified goods is unarguably a frustrating event.

(b) UCC 2-614

Under existing Anglo-Canadian law, if a stipulated method of performance becomes impossible the contract will, as a general rule, be deemed frustrated.<sup>37</sup> Certainly, this result will follow where the performance involves an essential term of the contract, and the contract does not require or permit a substitutional form of performance, however adequate or reasonable it may be in the circumstances. The rigidity of this rule can lead to manifestly uncommercial results, and can provide an unwilling party with an easy excuse for avoiding a bargain that has become unattractive to him on unrelated grounds. Similar difficulties arise where the agreed means or manner of payment fails because of domestic or foreign law. UCC 2-614 deals with both situations as follows:

2-614.(1) Where without fault of either party the agreed berthing, loading, or unloading facilities fail or an agreed type of carrier becomes unavailable or the agreed manner of delivery otherwise becomes commercially impracticable but a commercially reasonable substitute is available, such substitute performance must be tendered and accepted.

(2) If the agreed means or manner of payment fails because of domestic or foreign governmental regulation, the seller may withhold or stop delivery unless the buyer provides a means or manner of payment which is commercially a substantial equivalent. If delivery has already been taken, payment by the means or in the manner provided by the regulation discharges the buyer's obligation unless the regulation is discriminatory, oppressive or predatory.

The section would appear to be on very firm ground in importing at least a presumption that reasonable persons intend the bargain to be saved, if this can be achieved without serious prejudice, and do not intend that it should be frustrated on insubstantial grounds.<sup>38</sup> Accordingly, the Commission recommends adoption in the revised Ontario Act of a provision similar to UCC 2-614.<sup>39</sup>

<sup>37</sup>*Société Franco-Tunisienne d'Armement v. Sidermar S.P.A.*, [1961] 2 Q.B. 278; *Vancouver Milling & Grain Co. v. C.C. Ranch Co.*, [1924] S.C.R. 671. But see, *contra*, *Ocean Tramp Tankers Corp. v. V/O Sovfracht (The Eugenia)*, [1964] 2 Q.B. 226 (C.A.); *Tsakiroglou & Co. Ltd. v. Noble Thorl G. m.b.H.*, footnote 23 *supra*.

<sup>38</sup>See, NYLRC Study, ch. 5, footnote 52, *supra*, p. (543).

<sup>39</sup>See, Draft Bill, s. 8.14.

It will be noted, however, that section 2-614 is limited to questions of shipment and delivery. *Prima facie*, the section will not apply to supervening events affecting other aspects of the seller's performance. Suppose, for example, that a seller agrees to deliver goods labelled in a particular manner. Suppose, also, that subsequent legislation requires alteration in the contents, or display of the contents, of the label. It would surely be harsh to conclude that the contract has been frustrated because the seller can no longer perform in accordance with the letter of the agreement. Comments 5 and 6 to section 2-615 suggest a good faith approach in resolving problems not covered by the express language of that section. The rationale of section 2-614 suggests a similar solution where a substitutional mode of performance not restricted to questions of shipment is involved. It will also be noted that section 2-614 is silent with respect to adjustments in the price arising out of any substituted performance. Presumably this is to be implied.

We have considered the desirability of expanding our recommended provision to embrace the types of situation mentioned above. On balance, however, we have decided that these matters can safely be left to case law development, aided by the analogical and good faith principles enshrined in the proposed revised Act.

(c) UCC 2-615

Section 2-615 of the *Uniform Commercial Code* provides as follows:

2-615. Except so far as a seller may have assumed a greater obligation and subject to the preceding section on substituted performance:

- (a) Delay in delivery or non-delivery in whole or in part by a seller who complies with paragraphs (b) and (c) is not a breach of his duty under a contract for sale if performance as agreed has been made impracticable by the occurrence of a contingency the non-occurrence of which was a basic assumption on which the contract was made or by compliance in good faith with any applicable foreign or domestic governmental regulation or order whether or not it later proves to be invalid.
- (b) Where the causes mentioned in paragraph (a) affect only a part of the seller's capacity to perform, he must allocate production and deliveries among his customers but may at his option include regular customers not then under contract as well as his own requirements for further manufacture. He may so allocate in any manner which is fair and reasonable.
- (c) The seller must notify the buyer seasonably that there will be delay or non-delivery and, when allocation is required under paragraph (b), of the estimated quota thus made available for the buyer.

This section has three principal components. Paragraph (a) states the

circumstances in which a "delay in delivery or non-delivery in whole or in part" will be excused on grounds of frustration. Paragraph (b) introduces the principle of apportionment where, following the frustrating event, the seller is not left with sufficient supplies to meet all legitimate demands. Paragraph (c) imposes a notice requirement on the seller and follows logically from the duty to allocate and the right of election conferred on the buyer under section 2-616. It will be convenient to postpone discussion of paragraph (c) until we consider the provisions of UCC 2-616.

Paragraph (a) of UCC 2-615 raises the question of the basic purposes and applications of the doctrine of frustration. Various theories of the true "basis" of the frustration doctrine have been judicially asserted. One theory was stated by Lord Blackburn in *Taylor v. Caldwell*,<sup>40</sup> and holds that, from the nature of the contract, the courts find an implied term to the effect that, on the occurrence of certain events, performance will be excused. A second theory, which has its origins in the dissenting opinion of Viscount Haldane in *F.A. Tamplin Steamship Co. Ltd. v. Anglo-Mexican Petroleum Products Co. Ltd.*,<sup>41</sup> would view the contract as vanishing with the disappearance of the foundations of the contract. A third theory sees frustration as a device by which courts may reach the result that justice demands.<sup>42</sup> The first theory has come under attack lately in England<sup>43</sup> and in Canada,<sup>44</sup> and the third theory has gained in popularity. By contrast, UCC 2-615 follows the middle path; that is, the theory that the contract vanishes with the disappearance of its foundations.

Apart from the possible theoretical basis of the doctrine of frustration, there is the question of the situations to which the doctrine applies. Since *Taylor v. Caldwell*,<sup>45</sup> no one has questioned the application of a doctrine of frustration, however it is rationalized, to situations where performance has become impossible. The case of *Krell v. Henry*<sup>46</sup> expanded the application of the doctrine to instances where literal performance remained possible, but the underlying purpose of the contract seemed defeated. This extension, by means of a frustration of purpose test, met with mixed criticism;<sup>47</sup> and its status was uncertain in Ontario, at least until recently,<sup>48</sup> and still remains so in England. A third possible situation to

<sup>40</sup>(1863), 3 B. & S. 824, 839; 122 E.R. 309, 314 (Q.B.).

<sup>41</sup>[1916] 2 A.C. 397 (H.L.), at pp. 406-7.

<sup>42</sup>*Hirji Mulji v. Cheong Yue S.S. Co. Ltd.*, [1926] A.C. 497 (P.C.), at p. 510.

<sup>43</sup>For example, *Davis Contractors Ltd. v. Fareham U.D.C.*, [1956] A.C. 696 (H.L.), per Lord Radcliffe at pp. 728-29.

<sup>44</sup>For example, *Peter Kiewit Sons' Co. of Canada Ltd. v. Eakins Construction*, [1960] S.C.R. 361, 368; *Cahan v. Fraser*, [1951] 4 D.L.R. 112 (B.C.C.A.).

<sup>45</sup>*Supra*, footnote 40.

<sup>46</sup>[1903] 2 K.B. 740 (C.A.).

<sup>47</sup>See, Lord Wright in *Maritime National Fish Ltd. v. Ocean Trawlers Ltd.*, [1935] A.C. 524 (P.C.), at pp. 528-29; Lord Finlay, in *Larrinaga and Co. Ltd. v. Société Franco-Américaine des Phosphates De Medulla, Paris* (1922), 29 Com. Cas. 1, 7, 92 L.J.K.B. 455, 459 (H.L.); D. M. Gordon, Note (1936), 52 L.Q.R. 324; and, D. A. Landon, Note (1936), 52 L.Q.R. 168. See, also, *contra*, Lord Loreburn, in *F.A. Tamplin Steamship Co. Ltd. v. Anglo-Mexican Petroleum Products Co. Ltd.*, footnote 41 *supra*, at p. 403.

<sup>48</sup>See, *Capital Quality Homes Ltd. v. Colwyn Construction Ltd.* (1975), 9 O.R. (2d) 617, (1975) 61 D.L.R. (3d) 385 (C.A.), discussed *infra*, at p. 376.

which the frustration doctrine might be applied is the case where performance is possible, but would impose severe hardship upon the promisor.<sup>49</sup> This extension has received little judicial encouragement. It is to the second situation, that is, to frustration of the underlying purposes of the contract, that UCC 2-615 appears to address itself by applying a test of commercial impracticability, or commercial frustration. The question that needs consideration is whether this test should now be formally adopted in the revised Sale of Goods Act. Such a step would not be radical, and, we believe, can be justified on two grounds.

First, the existing law is not simply a test of literal impossibility.<sup>50</sup> The frustration of purpose test has been present, though little used, in Anglo-Canadian law since at least *Krell v. Henry*,<sup>51</sup> in which Vaughan Williams, L.J., stated a test of frustration, extending *Taylor v. Caldwell*<sup>52</sup> in terms not dissimilar to those adopted by the draftsmen of UCC 2-615. While, as noted, the courts have been divided in their reaction to *Krell v. Henry*, the Ontario Court of Appeal, in *Capital Quality Homes Ltd. v. Colwyn Construction Ltd.*,<sup>53</sup> recently gave new life to the principle expressed in that decision. The Court of Appeal held that a contract for the sale of land was frustrated by the enactment of certain provisions of *The Planning Act*<sup>54</sup> that prevented subdivision of the land. The Court stated as follows with respect to the "supervening event" that gives rise to frustration:<sup>55</sup>

The supervening event must be something beyond the control of the parties and must result in a significant change in the obligation assumed by them.

This language clearly supports a frustration of purpose test, and is consistent with the Code's test of commercial impracticability or frustration. The Court also emphasized that, in its view, the theory of the implied term "has been replaced by the more realistic view that the Court imposes upon the parties the just and reasonable solution that the new situation demands".<sup>56</sup> Since the buyer's known purpose to subdivide the land could not be realized, the contract was frustrated.<sup>57</sup>

The second reason for believing the change is not radical lies in the draftsmen's own interpretation of the scope of section 2-615(a), and in the

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<sup>49</sup>*Brauer & Co. (Great Britain) Ltd. v. James Clark (Brush Materials) Ltd.*, [1952] 2 All E.R. 497 (C.A.), per Denning, L.J., at p. 501; *Davis Contractors Ltd. v. Fareham U.D.C.*, footnote 19 *supra*, per Lord Reid, at p. 724.

<sup>50</sup>The literal impossibility test was the initial step taken in the application of frustration doctrine, and had its origins in *Taylor v. Caldwell*, footnote 40 *supra*.

<sup>51</sup>*Supra*, footnote 46.

<sup>52</sup>*Supra*, footnote 40.

<sup>53</sup>(1975), 9 O.R. (2d) 617, (1975), 61 D.L.R. (3d) 385 (C.A.). See also, the Comment on the case by Reiter, in (1978), 56 Can. Bar Rev. 98.

<sup>54</sup>R.S.O. 1970, c. 349.

<sup>55</sup>(1975), 9 O.R. (2d) 617, 623.

<sup>56</sup>*Ibid.*

<sup>57</sup>The Court, it should be noted, also discussed, but was not troubled by, the doctrine of equitable conversion, which states that equitable title passes to the buyer at the time the contract is entered into.

cautious attitude towards this provision displayed by American courts. Official Comment 4 to section 2-615 makes it clear that "increased cost alone does not excuse performance unless the rise in cost is due to some unforeseen contingency which alters the essential nature of performance". Something more substantial is required. The American courts have moved hesitantly in granting a non-performing party the shelter of UCC 2-615(a). A good example is the recent case of *Eastern Airlines Inc. v. Gulf Oil Corp.*<sup>58</sup> This case involved a contract for the supply of oil by Gulf Oil to Eastern Airlines. The contract rate was frozen because it had been pegged to a certain index for Texas oil that was itself artificially frozen by the U.S. Government. World prices, which Gulf had to pay, had, on the other hand, risen 400%. Gulf argued that it was a basic assumption of the contract that the index for Texas oil would continue to reflect world prices. On the basis of the available evidence and all the surrounding circumstances, the Court refused to make such a finding, and accordingly held that the contract had not been frustrated. The same reluctance has been shown by other American courts confronted with a defence under UCC 2-615, and one must look hard to find a case where frustration was permitted on grounds other than impossibility.<sup>59</sup>

There is little danger, therefore, that the adoption in Ontario of a provision similar to paragraph (a) of section 2-615 would result in ready acquiescence by the courts to attempts by dissatisfied buyers and sellers to seek relief from contracts that have lost their initial attraction. Further, we feel that the provision has positive merit, in that it leads to a more direct canvassing by the courts of the factors underlying the parties' common assumptions, and the important role played by economic considerations in shaping those assumptions.

We accept the test of commercial impracticability or frustration contained in UCC 2-615(a). Subject to the following consequential issues, we recommend that a provision comparable to UCC 2-615(a) be incorporated in the revised Ontario Act.

(i) *Foreseeability of event.* Official Comment No. 1 to section 2-615 suggests that the seller is not intended to be relieved of his contractual obligations where the contingency in question is sufficiently foreshadowed at the time of contracting to be fairly regarded as among the risks assumed by the seller. The cases interpreting UCC 2-615(a) treat foreseeability as a material factor,<sup>60</sup> and a persuasive case can be made for spelling this out expressly and not leaving it to implication. Indeed, it could be

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<sup>58</sup>(1975), 19 U.C.C. Rep. 721 (S.D. Fla.). See, also, *Maple Farms, Inc. v. City School Dist. of Elmira* (1974), 352 N.Y.S. 2d 784 (N.Y. Sup. Ct.); *Neal-Cooper Grain Co. v. Texas Gulf Sulphur Co.* (1974), 16 U.C.C. Rep. 7 (7th Cir.). See, further, Miniter, "Annual Workshop on Commercial and Consumer Law, 1976: What Was Said" (1977-78), 2 C.B.L.J. 364-67; Duesenberg, "Contract Impracticability: Courts Begin to Shape S. 2-615" (1977), 32 Bus. Law J. 1089.

<sup>59</sup>The *Neal-Cooper* case, *supra*, at least admitted of the possibility of frustration by commercial impracticability.

<sup>60</sup>For example, *Daburlos v. Commercial Ins. Co. of Newark, New Jersey* (1975), 521 F. 2d. 18 (3rd Cir.).

objected that the omission of an express reference to foreseeability leaves the false impression that "occurrence of a contingency the non-occurrence of which was a basic assumption on which the contract was made" is the conclusive test, and that factors other than those referred to in the section are to be ignored. While not denying the force of this reasoning, we have decided not to recommend a change in UCC 2-615(a) on this score. It is clear that its draftsmen intended the subsection to provide a flexible test; we think that it should remain that way. To attempt to enumerate all the factors that are relevant in determining whether frustration should be admitted as a defence would be a self-defeating task. Moreover, the foreseeability test is not very helpful. Many contingencies are foreseeable, and even "on the cards", in today's rapidly shifting world. Just as non-foreseeability should not provide an automatic defence, it would be mistaken to conclude that foreseeability of the event that has occurred should preclude a defence of frustration. All the relevant circumstances must be canvassed in each case. Accordingly, we recommend that the provision in the revised Act comparable to UCC 2-615(a) should not be amended to include specific reference to the element of foreseeability, or to other factors that would prevent frustration from being pleaded as a defence.

(ii) *Fault*. There is no express provision in UCC 2-615(a) disqualifying a seller whose "fault" contributes to the occurrence of the contingency, although the common law rule is that a party cannot rely on a self-induced act of frustration.<sup>61</sup> We recommend that the provision in the revised Act comparable to UCC 2-615(a) should make it clear that the section will not apply to excuse a seller whose fault contributes to the occurrence of the contingency in question.<sup>62</sup>

(iii) *Frustration of buyer's purpose*. As worded at present, section 2-615(a) only applies to events interfering with the seller's performance. Comment 9 to section 2-615 suggests that the rationale of the section may entitle the buyer to claim excuse where his contractual purpose has been frustrated. At least one state that has adopted the Code<sup>63</sup> has amended section 2-615 to make this explicit. We recommend a similar amendment to the corresponding provision in the revised Act. If this recommendation is accepted, the counterparts in the revised Act to the remaining provisions of UCC 2-615 and the provisions of UCC 2-616, which we discuss below, should also apply, *mutatis mutandis*, where the buyer's performance has been frustrated.<sup>64</sup>

As previously indicated, paragraph (b) of UCC 2-615 introduces the principle of apportionment where, following a frustrating event, the seller is left with insufficient supplies to satisfy all legitimate demands. In providing for the prorating of a scarce supply in a frustration context, UCC

<sup>61</sup>*Maritime National Fish Ltd. v. Ocean Trawlers Ltd.*, [1935] A.C. 524 (P.C.).

<sup>62</sup>See, Draft Bill, s. 8.15(a)(i), "by the occurrence of a contingency that was not due to the fault of either party . . ."

<sup>63</sup>Mississippi: see *Uniform Laws Annotated: Uniform Commercial Code* (1976), Vol. 1A, at p. 339. The Iowa Supreme Court interpreted UCC 2-615 as enacted to reach the same result: *Nora Springs Cooperative Co. v. Brandon* (1976), 20 U.C.C. Rep. 909.

<sup>64</sup>See, Draft Bill, s. 8.15(2).

2-615(b) presents a solution to a problem that has not been resolved by the courts.<sup>65</sup> A seller whose supply is unexpectedly and excusably limited, faced with the demands of a number of customers, might, at common law, be forced to allocate his supplies to one customer and suffer damage actions from the others. His defence of impossibility could be defeated by the fact that it was self-induced vis-à-vis the customers whom he did not satisfy. UCC 2-615(b) permits the seller to prorate his supply and to be excused with respect to the deficiencies. We support the principle of UCC 2-615(b). We would, however, extend its application to the offer of a short delivery not involving allocation of supplies among a number of customers, as where the buyer is the seller's only customer. Subject to this change, we recommend adoption in the revised Ontario Act of a provision comparable to UCC 2-615(b).<sup>66</sup>

With respect to the ability of the parties to contract out of the provisions of UCC 2-615, the section is expressed to apply "except so far as a seller may have assumed a greater obligation". Apart from its obvious meaning, this proviso is apparently also intended to lay down the rule that the section "provides a minimum beyond which agreement may not go".<sup>67</sup> If this is a sound construction, it seems a circuitous way of saying that the provisions of the section may not be excluded by the seller. The proviso also appears to be open to more serious objections. First, it is not obvious why the section should be subject to a special rule concerning excludability, and why the general doctrine of unconscionability is not sufficient to prevent overreaching by the seller.<sup>68</sup> Secondly, it is not clear what will be deemed to amount to a violation of the proviso. Presumably, it will not apply to a general clause in an agreement permitting the seller to terminate the contract at his discretion, even where no frustrating event has occurred. If this is correct, the proviso draws an invidious, and in our view unjustifiable, distinction between different types of termination clause. Conversely, if the proviso is capable of application to every type of termination clause, it clearly goes too far. Again, since UCC 2-615 only applies to the seller's performance obligations, the proviso might lead to the inference that termination clauses in favour of the buyer are not subject to a minimum standard of conscionability. This would obviously be an undesirable result. For these reasons, we recommend that the proviso "except so far as a seller has assumed a greater obligation", not be included in the section in the revised Act comparable to UCC 2-615. It follows that the parties would be free to vary the provisions of the section, subject to the doctrine of unconscionability.

(d) UCC 2-615(c) AND 2-616

As previously noted, paragraph (c) of UCC 2-615 requires the

<sup>65</sup>See, Hudson, "Prorating in the English Law of Frustrated Contracts" (1968), 31 Mod. L.R. 535.

<sup>66</sup>See, Draft Bill, s. 8.15(b).

<sup>67</sup>See, UCC 2-615, Comment No. 8. For other observations on the proviso, see NYLRC Study, ch. 5, footnote 52, *supra*, at p. (689).

<sup>68</sup>Compare, *Restatement of the Law, Contracts 2d*, Comment a to section 281, which clearly recognizes the parties' right to contract out under the comparable rule in the Restatement.

seller to notify the buyer of any delay or non-delivery, and of allocation. Section 2-615(c) should be read in conjunction with UCC 2-616, which provides as follows:

2-616.(1) Where the buyer receives notification of a material or indefinite delay or an allocation justified under the preceding section he may by written notification to the seller as to any delivery concerned, and where the prospective deficiency substantially impairs the value of the whole contract under the provisions of this Article relating to breach of installment contracts (Section 2-612), then also as to the whole,

- (a) terminate and thereby discharge any unexecuted portion of the contract; or
- (b) modify the contract by agreeing to take his available quota in substitution.

(2) If after receipt of such notification from the seller the buyer fails so to modify the contract within a reasonable time not exceeding thirty days the contract lapses with respect to any deliveries affected.

(3) The provisions of this section may not be negated by agreement except in so far as the seller has assumed a greater obligation under the preceding section.

We support the buyer's right to notice under UCC 2-615(c) and his right of election under section 2-616 as significant improvements on existing Anglo-Canadian law. Subject to the following comments concerning UCC 2-616(1)(b) and UCC 2-616(3), we recommend that the revised Act adopt provisions comparable to both UCC 2-615(c) and UCC 2-616.<sup>69</sup>

It will be noted that UCC 2-616(1)(b) does not contain language permitting the buyer to modify the contract by agreeing to a material or indefinite delay. We think that the provision in the revised Act comparable to UCC 2-616(1)(b) should make it clear that the buyer may modify the contract by agreeing to the delay, and we so recommend. In addition, UCC 2-616(1)(b) makes no provision for adjustment of the contract price where the buyer elects to modify the contract by agreeing to take his available quota. Provision for due allowance, is, however, made in UCC 2-613(b), in the case of casualty to identified goods. The Commission recommends that additional language entitling the buyer to claim due allowance should be included in the provision in the revised Act comparable to UCC 2-616(1)(b).<sup>70</sup> We deem this amendment desirable because of the position adopted under prior American law<sup>71</sup> that a buyer

<sup>69</sup>See, Draft Bill, ss. 8.15(c) and 8.16.

<sup>70</sup>See, Draft Bill, s. 8.16(1)(b).

<sup>71</sup>See, *Restatement of the Law of Contracts*, s. 463 and illustration 1; *Williston on Sales* (Rev. ed., 1948), para. 162. The English position generally has appeared to be the same: *McElroy and Williams, Impossibility of Performance* (1941), p. 25, although a recent case, *H. R. & S. Sainsbury Ltd. v. Street*, [1972] 3 All E.R. 1127 (Q.B.D.), suggests the buyer might be allowed to purchase at a reduced price.

was only entitled to part delivery on payment of the full contract price. Since this rule is explicitly rejected in UCC 2-613, doubts might arise if the same course were not followed in UCC 2-616.

There remains the question whether parties should be permitted to contract out of the provision in the revised Act comparable to UCC 2-616. Subsection (3) of section 2-616 states that the provisions of the section may not be negated by agreement, except insofar as the seller has assumed a greater obligation under UCC 2-615. While the prohibition against contracting out is free from the ambiguities in the proviso to UCC 2-615, discussed earlier, it is open to the same objection on the grounds of principle: it is not obvious why a rule of non-excludability is more necessary here than in other parts of Article 2 of the Code. We note that several American jurisdictions have deleted subsection (3) from their versions of UCC 2-616.<sup>72</sup> In our view, the general test of unconscionability previously recommended by us for adoption in the revised Act is sufficient, and we therefore recommend that a provision comparable to UCC 2-613(3) should not be adopted in the revised Act.

## 5. EFFECTS OF FRUSTRATION AND THE FRUSTRATED CONTRACTS ACT

At common law, the effects of the discharge of a contract by frustration on the rights and duties of the parties to the contract are complex and unsatisfactory.<sup>73</sup> Over the years, the common law rules have been exposed to much adverse criticism.<sup>74</sup> In the United Kingdom the *Law Reform (Frustrated Contracts) Act 1943*<sup>75</sup> was adopted in order to correct the most important defects. The counterpart in Canada to the U.K. Act is the *Uniform Frustrated Contracts Act*,<sup>76</sup> which was adopted in 1948 by the Conference of Commissioners on Uniformity of Legislation in Canada.<sup>77</sup> In Ontario, the Uniform Act was enacted as *The Frustrated Contracts Act*.<sup>78</sup> Most of the other common law provinces<sup>79</sup> have also adopted the Uniform Act. For reasons that remain obscure, both the U.K. and Canadian Acts exclude contracts for the sale of specific goods.<sup>80</sup> As a

<sup>72</sup>See, *Uniform Laws Annotated, Uniform Commercial Code*, Vol. 1A, at p. 345.

<sup>73</sup>It will suffice to note two particular difficulties. First, the rule in *Chandler v. Webster*, [1904] 1 K.B. 493 (C.A.), was that money paid under a frustrated contract could not be recovered because the action for money had and received would not lie unless the contract was void *ab initio*. This was specifically overruled in *Fibrosa Spolka Akcyjna v. Fairbairn, Lawson, Combe, Barbour, Ltd.*, [1943] A.C. 32 (H.L.), at pp. 48-49, 51-53, at least in cases where the consideration has wholly failed. Secondly, recompense for goods supplied ran into similar problems under the rule in *Appleby v. Myers* (1867), L.R. 2 C.P. 651 (Exch.), holding that where the promisor's obligation is entire, he cannot recover in contract or restitution unless he has fully performed.

<sup>74</sup>For example, McNair, "The Law Reform (Frustrated Contracts) Act, 1943" (1944), 60 L.Q.R. 160; Williams, footnote 18 *supra*; Payne, "Reform of the Law of Frustrated Contracts in Saskatchewan" (1960), 25 Sask. Bar Rev. 94.

<sup>75</sup>6 & 7 Geo. 6 (U.K.), c. 40.

<sup>76</sup>See, Feltham, "The Frustrated Contracts Act" (1960), 18 Advocate 5.

<sup>77</sup>Now known as the Uniform Law Conference of Canada.

<sup>78</sup>Now, R.S.O. 1970, c. 185.

<sup>79</sup>Nova Scotia and Saskatchewan excepted.

<sup>80</sup>For example, in Ontario, R.S.O. 1970, c. 185, s. 2(2)(c).

result, the common law rules continue to apply.<sup>81</sup> This is an omission that obviously should be rectified. We therefore recommend that the revised Act should provide that *The Frustrated Contracts Act* should apply in two situations: first, to a contract of sale of goods that has been terminated pursuant to the frustration provisions of the revised Act; and, secondly, to a buyer who has accepted partial or delayed performance in the case of a partial frustration.<sup>82</sup> We consider that this explicit reference to cases of partial frustration is necessary to avoid judicial doubts concerning the scope of *The Frustrated Contracts Act*. We note that a consequential amendment would be required, and accordingly recommend that *The Frustrated Contracts Act* should be amended to delete the exception of contracts of sale of goods from the application of the Act. Finally, there may be some overlap between the provisions of the revised Sale of Goods Act and *The Frustrated Contracts Act*. We therefore consider it desirable that a provision should be included in the revised Act to the effect that, in the case of a conflict between the two Acts, the provisions of the revised Sale of Goods Act shall prevail. We so recommend.<sup>83</sup>

Apart from the foregoing, we note that the research paper prepared for the Commission on the topic of frustration concludes<sup>84</sup> that *The Frustrated Contracts Act* is generally in need of review and revision, and makes a substantial number of recommendations for suggested improvements. These proposals are reproduced in an appendix to this Report.<sup>85</sup> This subject falls outside our terms of reference, and accordingly, has not been considered by the Commission. Nevertheless, the proposals put forward in the appendix may prove a useful basis for discussion by interested parties.

## RECOMMENDATIONS

The Commission makes the following recommendations:

1. Subject to the following, more specific, recommendations, the revised Act should adopt provisions comparable to UCC 2-613, 2-614, 2-615 and 2-616, dealing with the impact of the doctrine of frustration on the law of sales; the desirability of a general re-statement of frustration principles should be considered as part of the proposed Law of Contract Amendment Project.
2. Further to recommendation No. 12(a) in chapter 5, *supra*, the revised Act should adopt, in the context of a larger group of frustration provisions, a section comparable to UCC 2-613 dealing with casualty to identified goods in place of section 8 of the existing Sale of Goods Act. The section in the revised Act comparable to UCC 2-613 should, however, incorporate the following features:

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<sup>81</sup>See, Atiyah, *The Sale of Goods* (5th ed., 1975), at pp. 170-73, 176.

<sup>82</sup>See, Draft Bill, s. 8.17(1).

<sup>83</sup>*Ibid.*, s. 8.17(2).

<sup>84</sup>McCamus, footnote 1 *supra*, at pp. 85-90.

<sup>85</sup>See, Appendix 10 to this Report.

- (a) The section should not be confined to goods identified when the contract is made, but should apply also to goods that have been subsequently identified to the contract with the consent of both parties.
  - (b) Subject to recommendation (c), *infra*, the application of the section should not be restricted to cases where goods suffer casualty before risk of loss has passed to the buyer.
  - (c) Where risk of loss has not passed to the buyer, discharge of the seller should be limited by the buyer's right to compel partial performance with due allowance in the case of partial loss or destruction of the goods. Where, however, risk of loss is with the buyer, he should have the right to claim the remaining goods, but without an abatement in the price.
  - (d) In view of the recommendations in (b) and (c), *supra*, the section should expressly provide that, in the case of casualty to goods, the seller's obligation is discharged, but the buyer is discharged from the obligation to pay the price only if risk of such loss has not passed to the buyer.
  - (e) In order to exclude the operation of the section where casualty to goods is foreseeable or where the seller has undertaken to assume liability for delivery in any event, the section should include the words "unless the circumstances indicate that either party has assumed a greater obligation".
3. In order to make it clear that the term "fault" in the provision in the revised Act comparable to UCC 2-613 is intended to include loss due to negligence, the revised Act should adopt the Code definition of "fault".
  4. A provision comparable to UCC 2-614 dealing with substitutional performance in cases of frustration of shipment and delivery obligations should be included in the revised Act.
  5. The principle of substitutional performance contained in UCC 2-614 should not be extended expressly to other types of performance obligations; nor should the section make express reference to adjustment in the price arising out of any substituted performance. Rather, these matters should be left to case law development, aided by the recommended analogical and good faith provisions.
  6. The revised Act should incorporate a provision comparable to UCC 2-615(a) adopting a test of commercial impracticability or frustration to determine when a delay in delivery or non-delivery in whole or in part will be excused.
  7. The provision in the revised Act comparable to UCC 2-615(a) should not be amended to include specific reference to the element of foreseeability, or to other factors that would prevent frustration from being pleaded as a defence.

8. The provision in the revised Act comparable to UCC 2-615(a) should make it clear that the section will not apply to excuse a seller whose fault contributes to the occurrence of the contingency in question.
9. The provision in the revised Act comparable to UCC 2-615(a) should be expanded to apply expressly to non-performance by a buyer, and the counterparts in the revised Act to the remaining provisions of UCC 2-615 and the provisions of UCC 2-616 should apply, *mutatis mutandis*, where the buyer's performance has been frustrated.
10. The revised Act should incorporate a provision comparable to UCC 2-615(b) requiring the seller to allocate his production and deliveries where a delay in delivery or non-delivery in whole or in part affects only a part of the seller's capacity to perform; the application of the section should, however, be extended to the offer of a short delivery not involving allocation of supplies among a number of customers, as where the buyer is the seller's only customer.
11. In order to permit the parties to a contract to vary the provisions of UCC 2-615, subject to the doctrine of unconscionability, the words "except so far as a seller has assumed a greater obligation", contained in UCC 2-615, should not be included in the provision in the revised Act comparable to UCC 2-615.
12. A provision comparable to UCC 2-615(c) requiring the seller to notify the buyer of a delay or non-delivery or of allocation should be incorporated in the revised Act.
13. Subject to the following three amendments, the revised Act should include a provision similar to UCC 2-616:
  - (a) Additional language entitling the buyer to modify the contract by agreeing to a material or indefinite delay should be included in the provision comparable to UCC 2-616(1)(b).
  - (b) Additional language entitling the buyer to claim due allowance from the contract price should be included in the provision comparable to UCC 2-616(1)(b).
  - (c) Subject to the doctrine of unconscionability, the parties should be free to contract out of the provisions of UCC 2-616. Accordingly, a provision comparable to UCC 2-616(3) should not be adopted in the revised Act.
14. The revised Act should provide that *The Frustrated Contracts Act* shall apply: (a) to a contract of sale that has been terminated pursuant to the frustration provisions of the revised Act; and, (b) to a buyer who has accepted partial or delayed performance in the case of a partial frustration.

15. *The Frustrated Contracts Act* should be amended to delete the exception of contracts of sale of goods from the application of that Act.
16. The revised Act should contain a provision to the effect that, in the case of a conflict between the provisions of *The Frustrated Contracts Act* and the revised Sale of Goods Act, the provisions of the revised Sale of Goods Act shall prevail.



## PART VI

### SELLER'S AND BUYER'S REMEDIES FOR BREACH OF CONTRACT

#### INTRODUCTION

Both *The Sale of Goods Act* and Article 2 of the *Uniform Commercial Code* treat separately the seller's and buyer's remedies for breach of the other's obligations. It will be convenient to follow the traditional pattern in this part of the Report. This is not to suggest that these remedies constitute two solitudes, without common points of contact. Nor do we suggest that greater attempts should not be made to integrate the underlying principles and policies. One of the merits of the Code is that it strives for this conscious parallelism. In the ensuing discussion, chapter 16 deals with the seller's remedies and chapter 17 with the buyer's remedies. Since a substantial number of remedial issues are common to both parties, we deal with these common issues separately in chapter 18.

*The Sale of Goods Act* distinguishes<sup>1</sup> between the seller's real and personal remedies. Real remedies in this context refer to the seller's rights in relation to the goods that can be exercised extra-judicially and that constitute a form of security for payment of the price. The seller's personal remedies, on the other hand, involve an action against the buyer for performance of the buyer's obligations or damages for breach of contract. The seller's real remedies comprise the rights of lien,<sup>2</sup> stoppage *in transitu*,<sup>3</sup> and resale.<sup>4</sup> His personal remedies are represented by an action for the price<sup>5</sup> or a claim for damages.<sup>6</sup> Independently of these remedies, the seller may also have the right to rescind, that is, to cancel, the contract if the necessary prerequisites are satisfied.

On the buyer's side, there is no true analogue to the seller's real remedies. Unlike the *Uniform Sales Act*<sup>7</sup> and now the *Uniform Commercial Code*,<sup>8</sup> *The Sale of Goods Act* confers no lien rights in favour of an aggrieved buyer who is in possession of rejected goods for which he has paid. The buyer's counterpart to the seller's action for the price is the action for specific performance.<sup>9</sup> In the alternative, where the property in the goods has passed to the buyer, he may seek an order of specific restitution<sup>10</sup> and, in Ontario, he may also be entitled to bring an action in replevin.<sup>11</sup> Of the buyer's other remedies, his right to reject non-conforming goods usually coincides with the exercise of a right of cancellation, and is a most powerful remedy. His claim to damages is conceptually the same as the seller's, both being based on the test of foreseeability, a test that is usually referred

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<sup>1</sup>See, ss. 37-47 and 48-49, 52.

<sup>2</sup>Ss. 39-41.

<sup>3</sup>S. 42.

<sup>4</sup>S. 46.

<sup>5</sup>S. 47.

<sup>6</sup>Ss. 48, 52.

<sup>7</sup>See, s. 69(5).

<sup>8</sup>UCC 2-711(3).

<sup>9</sup>*The Sale of Goods Act*, s. 50.

<sup>10</sup>*Cohen v. Roche*, [1927] 1 K.B. 169.

<sup>11</sup>*The Replevin Act*, R.S.O. 1970, c. 412, s. 2.

to as the rule or rules in *Hadley v. Baxendale*.<sup>12</sup> Quantitatively, however, the buyer's claim is potentially much more formidable; it may include a claim for consequential losses many times the size of the purchase price. Hence, the seller will frequently attempt to exclude or curtail such damage claims by the use of disclaimer clauses.

The differences between the treatment of seller's and buyer's remedies in Article 2 of the *Uniform Commercial Code* and the treatment accorded these remedies in *The Sale of Goods Act* are both numerous and important. The *Uniform Sales Act* contained important deviations from the principles adopted in *The Sale of Goods Act*, and Article 2 has added significantly to their number.<sup>13</sup> Among the more noteworthy innovations may be mentioned the following: namely, the seller's expanded right of resale and his right to recover an actual deficiency;<sup>14</sup> the buyer's right to cover;<sup>15</sup> the abandonment of title concepts in determining the seller's right of retention and right to sue for the price;<sup>16</sup> both parties' right to seek assurances of performance<sup>17</sup> where a breach is apprehended but has not yet materialized; the seller's right to cure a non-conforming tender;<sup>18</sup> and, the buyer's enlarged rights to seek specific performance.<sup>19</sup> These points will be developed in the chapters that follow. Article 2 also strives for a more systematic and comprehensive, although not exhaustive, treatment of this branch of sales law. This feature, coupled with the Code's conceptual and practical improvements, provide a rich storehouse of ideas for desirable changes in the existing Ontario Act.

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<sup>12</sup>(1854), 9 Exch. 341.

<sup>13</sup>See, generally, Peters, "Remedies for Breach of Contracts Relating to the Sale of Goods under the Uniform Commercial Code: A Roadmap for Article Two" (1963), 73 Yale L.J. 199.

<sup>14</sup>UCC 2-706.

<sup>15</sup>UCC 2-712.

<sup>16</sup>UCC 2-703(a); 2-709(1).

<sup>17</sup>UCC 2-609.

<sup>18</sup>UCC 2-508.

<sup>19</sup>UCC 2-716.

#### 1. INDEX OF SELLER'S REMEDIES AND CHARACTERIZATION OF BUYER'S BREACH

Section 38 of *The Sale of Goods Act* indexes the real remedies of an unpaid seller, but provides no index with respect to the seller's personal remedies.<sup>1</sup> The Code differs from the Ontario Sale of Goods Act in this respect; UCC 2-703 purports to index both the seller's personal and real remedies. The section reads as follows:<sup>2</sup>

2-703. Where the buyer wrongfully rejects or revokes acceptance of goods or fails to make a payment due on or before delivery or repudiates with respect to a part or the whole, then with respect to any goods directly affected and, if the breach is of the whole contract (Section 2-612), then also with respect to the whole undelivered balance, the aggrieved seller may

- (a) withhold delivery of such goods;
- (b) stop delivery by any bailee as hereafter provided (Section 2-705);
- (c) proceed under the next section respecting goods still unidentified to the contract;
- (d) resell and recover damages as hereafter provided (Section 2-706);
- (e) recover damages for non-acceptance (Section 2-708) or in a proper case the price (Section 2-709);
- (f) cancel.

In our view, section 2-703 is a useful, although not essential, provision, and we recommend that the revised Act adopt a similar, but substantially amended, section.<sup>3</sup>

We deal hereafter with the specific remedies listed in UCC 2-703, but several observations of a general character may be in order at this point. In the first place, UCC 2-703 is not exhaustive. It enumerates only those remedies that are specifically dealt with in Article 2; it does not, for example, refer to the seller's general right to recover damages for breach of the buyer's obligations. Presumably, this and other gaps are to be filled by general principles of contract law. Secondly, UCC 2-703 is not merely an index provision; it is also substantive in character. Two of the remedies

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<sup>1</sup>For a general discussion of the topic of seller's remedies, see, Baer, "Seller's Remedies", Research Paper No. III. 9.

<sup>2</sup>UCC 2-703 must be read in conjunction with UCC 2-702, which deals with the seller's remedies on discovery of the buyer's insolvency.

<sup>3</sup>See, Draft Bill, s. 9.3.

listed in the section, the right to withhold delivery<sup>4</sup> and the right to cancel,<sup>5</sup> are not further elaborated in later sections. The right to withhold delivery is the Code's nomenclature for the right of lien or retention conferred under *The Sale of Goods Act*.<sup>6</sup> The right to cancel is not specifically referred to in the Ontario Act, but is necessarily implied. "Cancellation" is defined in UCC 2-106(4) as occurring "when either party puts an end to the contract for breach by the other and its effect is the same as that of 'termination' except that the cancelling party also retains any remedy for breach of the whole contract or any part thereof".<sup>7</sup> "Cancellation" is therefore the Code's synonym for the very ambiguous term "rescission", commonly used in Anglo-Canadian law to describe an innocent party's right to put an end to a contract for breach by the other contracting party. Rescission of a contract is implied under existing law where, for example, a seller is permitted to sue for damages for the buyer's neglect or refusal to accept and pay for goods, or where a buyer rejects non-conforming goods on or after the contractual date of delivery. We much prefer the Code's concept of cancellation to the common law's confusing terminology of rescission. We recommend, therefore, that the index section of seller's remedies in the revised Act should refer explicitly to the seller's right to cancel.<sup>8</sup>

Finally, a most important difference apparently resides between the Code's treatment of a breach by the buyer, and the treatment of such a breach under Anglo-Canadian law. Under the Code's "perfect tender" rule, any breach by the buyer, whether major or minor, apparently entitles the seller to cancel the contract and to exercise the remedies enumerated in UCC 2-703. Under Ontario law, the seller can only cancel the contract when the buyer's breach amounts to breach of a condition. This difference is particularly important with respect to the buyer's payment obligations, and is reflected in the contrast between the Code's treatment of the buyer's failure to make punctual payment, and the consequences attached to such a failure by *The Sale of Goods Act*. A literal reading of UCC 2-703 leads to the conclusion that any delay in payment, however short, is treated as a breach of an essential term, and entitles the seller to cancel the contract and to exercise, as appropriate, the other remedies referred to in the section.<sup>9</sup> It is not clear whether the same strict performance test will be applied to other breaches by the buyer; for example, the failure to take delivery of the goods at the right time. By way of contrast, reference may be made to the buyer's remedies in the case of a non-conforming tender or delivery by the seller. The Code affords the seller an opportunity to

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<sup>4</sup>UCC 2-703(a).

<sup>5</sup>UCC 2-703(f).

<sup>6</sup>S. 38.

<sup>7</sup>"Termination" is defined in UCC 2-106(3) as occurring "... when either party pursuant to a power created by agreement or law puts an end to the contract otherwise than for its breach. On 'termination' all obligations which are still executory on both sides are discharged but any right based on prior breach or performance survives". Compare, Draft Bill, s. 1.1(2)(b).

<sup>8</sup>See, Draft Bill, ss. 9.3(2), and 9.12(2) (dealing with the buyer's right in the converse situation), and the definition of "cancellation" in s. 1.1(2)(c).

<sup>9</sup>Surprisingly little attention appears to be paid to this feature in the standard Code texts. For the position under the *Uniform Sales Act*, see ss. 61, 65; and compare, *Williston on Sales* (Rev. ed., 1948), secs. 453b, 550.

cure his breach,<sup>10</sup> and there are a substantial number of other instances<sup>11</sup> in which the Code makes exceptions to the "perfect tender" rule. With one exception,<sup>12</sup> no similar indulgences appear to be made in the buyer's favour.

With respect to breaches by the buyer, *The Sale of Goods Act* does not, as we have noted previously, characterize the relative importance of the buyer's obligations. In the typical contract of sale, the buyer's primary obligations are to pay for, and to take delivery of, the goods. Section 11 of *The Sale of Goods Act* expressly provides that time of payment is not of the essence, unless the contract evinces a different intention. While section 11 does not address itself to the buyer's obligation to take delivery of the goods, the ambiguous case law<sup>13</sup> appears to support the same conclusion; that is, that time is not of the essence in the absence of special circumstances.

We have previously recommended<sup>14</sup> that the revised Act should eschew *a priori* characterization of obligations, whether they be obligations of the seller or buyer, and that, instead, remedies should turn on the gravity of the breach and whether or not it is substantial in character. In the seller's context, this means that, in the absence of contrary agreement, he would not be entitled to cancel the contract for untimely payment or for breach of any other obligation by the buyer, nor to exercise the other remedies consequent upon cancellation (specifically the right of resale and the right to sue for damages for non-acceptance) unless the buyer were guilty of a substantial breach. We think that this distinction should be clearly drawn in the section of the revised Act that indexes the seller's remedies. Accordingly, we recommend that this index section should distinguish between the remedies for substantial and for non-substantial breaches of a contract of sale.<sup>15</sup>

It will be convenient, at this stage, to set out our recommended index section of seller's remedies. Our draft provision reads as follows:<sup>16</sup>

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<sup>10</sup>UCC 2-508.

<sup>11</sup>See, UCC 2-323(2), 2-504, 2-608, 2-612.

<sup>12</sup>UCC 2-612(3) (dealing with breach of instalment contract). Subsection (3) does not expressly refer to breaches by the buyer, but may fairly be construed as applying to breaches by either party.

<sup>13</sup>See, for example, *Woolfe v. Horn* (1877), 2 Q.B.D. 355; and *Kidston and Company v. Monceau Iron Works Co. Ltd.* (1902), 7 Com. Cas. 82; and Atiyah, *The Sale of Goods* (5th ed., 1975), at pp. 139-40. Note, however, the more restrictive view of the law taken in *Benjamin's Sale of Goods* (1974), para. 674. Section 36 of the Ontario Sale of Goods Act also supports Atiyah's position, and, presumably, the seller's right under section 48(1) of the Act to bring an action for non-acceptance does not arise unless the buyer's conduct amounts to a substantial breach. The precise relationship between sections 11, 27, 36 and 48(1) of *The Sale of Goods Act* still awaits authoritative judicial exposition. Note, too, that the time of taking delivery will be regarded as of the essence when the goods are perishable (*Sharp v. Christmas* (1892), 8 T.L.R. 687 (C.A.); *Mooney v. Lipka*, [1926] 4 D.L.R. 647 (Sask. C.A.)) and in the case of a spot contract (*Thames Sack and Bag Co., Lim. v. Knowles & Co. Lim.* (1918), 88 L.J.K.B. 585).

<sup>14</sup>*Supra*, ch. 6, sec. B.

<sup>15</sup>See, Draft Bill, s. 9.3.

<sup>16</sup>*Ibid.*

- (1) Where the buyer breaches the contract, the seller may,
  - (a) maintain an action for damages;
  - (b) withhold delivery of any goods in his possession;
  - (c) stop delivery by any bailee;
  - (d) in a proper case recover the price,

as provided in this Act.

(2) Where the buyer's conduct amounts to a substantial breach, the seller, in addition to his rights under subsection 1, may exercise any one or more of the following rights:

1. Cancel the contract
  - (i) with respect to any undelivered goods,
  - (ii) where the buyer has wrongfully rejected or revoked acceptance, or
  - (iii) where the goods are in the buyer's possession and the seller is otherwise entitled to reclaim them.
2. Proceed under section 9.5 respecting goods still unidentified to the contract.
3. Resell and recover damages as provided in this Act.

We appreciate that our recommendation in favour of a test of substantiality may appear to encourage uncertainty. However, the uncertainty exists now. Moreover, some degree of uncertainty is, in our view, a justifiable price for the greater measure of flexibility and prevention of hardship provided by the test of substantiality.

Nevertheless, we recognize that uncertainty should be reduced wherever possible. We believe that this can be achieved by allowing the seller, in the case of the buyer's late payment or failure to take delivery, to treat the breach as a substantial breach, whether or not it would otherwise be a substantial breach, where the buyer has failed to cure his default after being given reasonable notice by the seller to do so. We recommend that the revised Act incorporate a provision to this effect.<sup>17</sup> It should also be emphasized that the parties will retain their contractual freedom to characterize the importance of the buyer's obligation and the consequence of a breach thereof. In such a case, the seller will not need to rely on his right to demand cure. Even in the absence of such an agreement, the seller will retain the right to argue that the initial breach amounted to a substantial breach, if he is satisfied that the facts warrant such a claim.

There are important precedents for our recommendation. These are found, first, in section 46(3) of the existing Sale of Goods Act and, secondly, in the "Nachfrist" provisions in the Uniform Law on the International Sale of Goods (ULIS) and in Articles 45(1) and 46(1) of the

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<sup>17</sup>*Ibid.*, s. 9.4.

1977 draft UNCITRAL sales Convention.<sup>18</sup> Section 46(3) of *The Sale of Goods Act* is examined more fully later in this chapter; suffice it to say at this juncture that it entitles the unpaid seller to resell the goods in his possession, notwithstanding that title may have passed to the buyer, where the goods are of a perishable nature or when he "gives notice to the buyer of his intention to resell and the buyer does not within a reasonable time pay or tender the price". Articles 45(1) and 46(1) of the draft UNCITRAL Convention provide as follows:

*Article 45*

(1) The seller may fix an additional period of time of reasonable length for performance by the buyer of his obligations.

*Article 46*

(1) The seller may declare the contract avoided:

- (a) if the failure by the buyer to perform any of his obligations under the contract and this Convention amounts to a fundamental breach of contract; or
- (b) if the buyer has not, within the additional period of time fixed by the seller in accordance with paragraph (1) of article 45, performed his obligation to pay the price or taken delivery of the goods, or if he has declared that he will not do so within the period so fixed.

It will be observed that, while section 46(3) of *The Sale of Goods Act* is restricted to delay in payment, the UNCITRAL provisions also embrace delay in taking delivery. In both cases, the seller may declare the contract avoided; that is, cancelled. He is not obliged to resell the goods if he does not wish to do so. We support the principle of the UNCITRAL provisions and, in accordance with our recommendation, have sought to give effect to them in our Draft Bill.<sup>19</sup> As we have noted, the seller would not be obliged to resort to the section if he is satisfied that the buyer's breach

<sup>18</sup>For the ULIS provisions see Arts. 62(2) and 66(2). "Nachfrist" is the German term for the additional period of time that a creditor may allow a defaulting debtor (not necessarily a buyer or seller) before being entitled to treat the non-performance as amounting to a substantial breach of the debtor's obligation. See, further, Cohn, *Manual of German Law* (2nd ed., 1968), Vol. II, secs. 226-27; and Treitel, "Remedies for Breach of Contracts", in *International Encyclopedia of Comparative Law*, Vol. VII, ch. 16, secs. 11, 149-50. It should be emphasized that while the ULIS and UNCITRAL provisions have been influenced by the German concept, they are not identical with it in scope or detail. (We are indebted to Dr. Ulrich Drobnig of the Max Planck Institut in Hamburg for making much of the foregoing information available to us.)

Another precedent for our recommendation lies in equity which, while not ordinarily treating time as of the essence in contractual stipulations, would allow the aggrieved party to make it of the essence after serving a demand for performance on the party in default. Compare, Cheshire & Fifoot, *The Law of Contract* (7th ed., 1969), at p. 495; *Stickney v. Keeble*, [1915] A.C. 386; *Ajit v. Sammy*, [1967] A.C. 255.

<sup>19</sup>See, Draft Bill, s. 9.4.

already amounts to a substantial breach of the contract, or if the contract itself treats the breach as a substantial breach.

Two further points require consideration. The first is whether the seller's right to convert a minor breach into a substantial breach for the buyer's failure to take delivery should apply, even where the price, or a part thereof, has been paid. It is arguable that the seller suffers no serious prejudice in such a case and that, as is provided in section 36 of the Ontario Sale of Goods Act in respect of uncollected goods generally, he should be content with a claim in damages. While recognizing the force of this reasoning we have, in the interests of simplicity, decided not to distinguish between cases where the seller is unpaid, and cases where payment has been made in full or in part. Our reason is that it would require the drawing of fine distinctions between partly paid and fully paid goods, and between durable goods and those goods that are perishable or decline in value and that therefore require prompt action by the seller. Such complexities hardly seem warranted. Accordingly, we recommend that the seller should have the right, upon the buyer's failure to take delivery, to convert the buyer's minor breach into a substantial breach, notwithstanding that the buyer may have paid for the goods, in full or in part.

The second point is whether the seller's right to demand cure should be extended to all breaches by the buyer, or whether it should be restricted to cases where the buyer fails to make payment or to take delivery of the goods. We were initially attracted by the suggestion that it should be so extended, especially where the buyer is in a position to cure his default without undue expense, risk or prejudice to himself. We were, however, subsequently persuaded that the probable costs of such an extension would exceed any possible benefits. Nevertheless, we favour an enlarged construction of the meaning of payment and taking delivery, so as to include such preparatory steps (for example, the opening of a letter of credit or the designation of a vessel or other carrier) as may reasonably be considered part of the buyer's obligations to make payment and to take delivery. We so recommend.<sup>20</sup>

## 2. REAL REMEDIES

As previously mentioned, the seller's real remedies encompass the right of lien or retention, the right of stoppage, and the right of resale. With the exception of cases dealing with the right of resale, most, if not all, of the leading cases involving the seller's real remedies are of pre-1893 origin, and the statutory provisions have since then engendered only a modest amount of litigation. This suggests either that these provisions are uncontroversial, or that changes in selling practices and the extension of credit have substantially reduced their practical significance. Certainly, the latter explanation applies to the right of stoppage *in transitu*. In any event, we do not find it necessary to review the provisions in detail, and our attention will largely be confined to those provisions that would appear to be in need of clarification or revision. We shall deal first with the treatment of real remedies under *The Sale of Goods Act*, and then compare the provisions of this Act with those of the *Uniform Commercial Code*.

<sup>20</sup>*Ibid.*, s. 9.4(2).

## (a) THE EXISTING LAW

Section 38 of *The Sale of Goods Act* indexes the real remedies of an "unpaid seller" as defined in the Act.<sup>21</sup> This section provides as follows:

38.(1) Subject to this Act and any statute in that behalf, notwithstanding that the property in the goods may have passed to the buyer, the unpaid seller of goods, as such, has by implication of law,

- (a) a lien on the goods or right to retain them for the price while he is in possession of them;
- (b) in case of the insolvency of the buyer, a right of stopping the goods in transitu after he has parted with the possession of them;
- (c) a right of resale as limited by this Act.

(2) Where the property in goods has not passed to the buyer, the unpaid seller has, in addition to his other remedies, a right of withholding delivery similar to and co-extensive with the rights of lien and stoppage in transitu where the property has passed to the buyer.

We now turn to consider a number of points raised by the section.

(i) *The Relevance of Title*

Section 38 distinguishes between cases where property in the goods has passed to the buyer and cases where property has not so passed. In the former case, the seller has a right of lien, a right of stoppage and a right of resale; in the latter case, however, section 38(2) makes no specific mention of the right of resale. It is generally accepted that this omission is not fatal, since a seller with title does not need a statutory *power* of resale. The power derives from his status as owner,<sup>22</sup> although, it may be argued that this does not answer the question whether he has a *right* of resale. Our view is that, like other parts of the Act, the section betrays an obsession with title and its consequences that is unnecessary for the purposes of determining the parties' rights. As will be seen, here as elsewhere, Article 2 has abandoned property concepts and has substituted a functional test. We favour the same approach in the revised Act and accordingly recommend that, with respect to the seller's real remedies, the revised Act should draw no distinction between those cases in which title has passed to the buyer, and those in which it has not.

<sup>21</sup>See, s. 37(1).

<sup>22</sup>See, Baer, footnote 1 *supra*, at pp. 30-31. Atiyah, *The Sale of Goods* (5th ed., 1975), at pp. 249-50, draws a distinction between the power of resale and the right of resale and argues that, while the retention of ownership in the goods confers a power on the unpaid seller to pass a good title to a third party, it does not necessarily make his action rightful vis-à-vis the buyer. This apparent paradox is convincingly explained in Professor Baer's paper; and see, also, *R. V. Ward Ltd. v. Bignall*, [1967] 1 Q.B. 534 (C.A.); and compare, *Robinson v. Long*, [1923] 3 D.L.R. 918 (N.B.S.C., App. Div.).

(ii) *Lien Right (Right of Retention)*

By section 38(1), an unpaid seller has a lien on goods for the price, while they are in his possession, and notwithstanding that the property in the goods may have passed to the buyer. Section 38(2) confers an equivalent right upon the unpaid seller where property in the goods has not passed to the buyer. The unpaid seller's lien right is merely a logical consequence of the statutory rule<sup>23</sup> that the seller's duty to tender delivery and the buyer's duty to pay for the goods are concurrent conditions. The reasonableness of the lien right requires no justification. There are, however, a substantial number of subsidiary questions involving the creation and duration of the lien that require examination.

The two conditions essential to the creation of the lien, as stated in section 38(1)(a) of the Act, are that the seller must be unpaid, and that he must be in possession of the goods. Of course, if the seller has agreed to extend credit, he cannot justify withholding the goods on the grounds of non-payment. This is necessarily implied in subsection (1)(a) of section 39 of the Act. Section 39 provides as follows:

39.(1) Subject to this Act, the unpaid seller of goods who is in possession of them is entitled to retain possession of them until payment or tender of the price,

- (a) where the goods have been sold without any stipulation as to credit;
- (b) where the goods have been sold on credit but the term of credit has expired; or
- (c) where the buyer becomes insolvent.

(2) The seller may exercise his right of lien notwithstanding that he is in possession of the goods as agent or bailee for the buyer.

However, an apparent difficulty is created because of the provision in section 39(1)(b), the effect of which is to revive the seller's lien "where the goods have been sold on credit but the term of credit has expired". Read literally,<sup>24</sup> this suggests that the seller could take advantage of his own failure to deliver. Although this result was probably not intended, the ambiguity should be resolved. Accordingly, we recommend that the provision in the revised Act dealing with the seller's right of lien should make it clear that, where the seller has extended credit, he cannot justify withholding the goods on the ground of non-payment where he has not met his delivery obligations.<sup>25</sup>

*The Sale of Goods Act* is unusually detailed in spelling out the ramifications of the seller's lien right in various circumstances. However, there are still significant gaps, and in other cases the provisions of the Act are open to question on grounds of policy. This is true of a number of situations, which we now discuss.

<sup>23</sup>*The Sale of Goods Act*, s. 27.

<sup>24</sup>See, Baer, footnote 1 *supra*, at p. 6.

<sup>25</sup>See, Draft Bill, s. 9.7(1)(a).

(1) *Seller in Possession as Agent*

Section 39(2) of *The Sale of Goods Act* affirms the seller's lien right, even though he is in possession of the goods as agent or bailee for the buyer.<sup>26</sup> Assume, however, that the buyer has elected to leave the goods with the seller, even though he was entitled to delivery; it may be contended that, in this situation, the seller's right to claim a lien because of supervening events is anomalous. This is particularly so if the seller carries on a separate business as bailee and charges for his services. While this may be conceded, it must also be recognized that it is often difficult to determine the precise time when a seller, who has not formally agreed to retain the goods for safekeeping, assumes the garb of a bailee. In our view, section 39(2) at least has the merit of avoiding the need to draw fine distinctions. On balance, therefore, we favour retaining the provision, and accordingly recommend that the substance of section 39(2) be reproduced in the revised Act.<sup>27</sup>

(2) *Part Delivery*

Section 40 of *The Sale of Goods Act* provides as follows:

40. Where an unpaid seller has made part delivery of the goods, he may exercise his right of lien or retention on the remainder unless the part delivery has been made under such circumstances as show an agreement to waive the lien or right of retention.

This section merits clarification. It fails to distinguish between an entire or indivisible contract and an instalment or divisible contract.<sup>28</sup> It also fails to indicate whether, in an instalment contract, the unpaid seller may assert a general lien on future instalments to cover payment owing on previous instalments. Although the case law appears to deny such a right,<sup>29</sup> on the ground of the severable nature of the instalments, we favour its recognition. Accordingly, we recommend that the provision in the revised Act dealing with the seller's right to withhold delivery should make it clear that the seller's right to withhold where there has been part delivery covers amounts due under an instalment contract, as well as amounts due under an entire or indivisible contract.<sup>30</sup>

We do not, however, favour enlarging the seller's right still further, so as to confer a lien in respect of *future* payments as well as overdue payments. Our opposition to such a proposal rests on several grounds. First, it would depart significantly from existing law, which recognizes no such

<sup>26</sup>There is some controversy concerning the extent, if any, to which this provision changed the common law. *Benjamin's Sale of Goods* (1974), para. 1070, claims that it did, but the contrary position appears to be adopted in *Williston on Sales* (Rev. ed., 1948), sec. 506, commenting at large on s. 54 of the *Uniform Sales Act*. See, also, *Chalmers' Sale of Goods Act 1893* (16th ed., 1971), pp. 173-75.

<sup>27</sup>See, Draft Bill, s. 9.7(3).

<sup>28</sup>On instalment contracts, see s. 30 of *The Sale of Goods Act*, and *infra*, ch. 18.

<sup>29</sup>See, for example, *Snagproof Limited v. Brody* (1922), 69 D.L.R. 271 (Alta. S.C., App. Div.), especially at p. 275.

<sup>30</sup>See, Draft Bill, s. 9.7(4).

right.<sup>31</sup> Secondly, a proposal of this nature would conflict with the general treatment of instalment contracts as proposed later in this Report.<sup>32</sup> Thirdly, it would lead to the anomalous result that a seller in an instalment contract would have greater rights than a seller under an indivisible contract, where delivery is to be made in one instalment. Finally, an instalment seller who feels insecure about future payment can always invoke his right to seek an adequate assurance of performance, pursuant to a recommendation made later in this Report.<sup>33</sup>

### (3) *Effect of Judgment on Lien*

Section 41(2) of *The Sale of Goods Act* restates the common law rule that the unpaid seller does not lose his lien right by reason only that he has obtained a judgment for the price. Read literally, the statutory language does not cover the position where a judgment has been obtained after a stoppage *in transitu*. It is, however, reasonable to assume that the draftsman intended the same rule to apply in both situations.<sup>34</sup> In any event, the position should be clarified in the revised Act. Accordingly, we recommend that the revised Act should make it clear that a judgment for the price does not affect either the seller's right to withhold delivery or the seller's right of stoppage.<sup>35</sup>

### (4) *Non-Possessory Lien Rights Where Buyer Insolvent; UCC 2-702*

Under *The Sale of Goods Act*, an unpaid seller has a right of lien only while the goods are in his possession, although, where the buyer is insolvent, the unpaid seller who has parted with possession of the goods may also stop them in the course of transit. A difficult question is whether the revised Act should recognize a limited statutory non-possessory lien, as does UCC 2-702(2),<sup>36</sup> in a case where the buyer has become insolvent after receiving the goods. The Code subsection entitles the seller to reclaim the goods if a demand for their return is made within 10 days of their receipt. The ten-day limitation does not apply if a misrepresentation of solvency has been made to the seller within three months of the delivery of the goods. The seller's rights of reclamation are subject to the rights of a buyer in ordinary course or other good faith purchaser from the seller's buyer.<sup>37</sup> A comparable provision, involving the buyer's right of recovery

<sup>31</sup>See, *Benjamin's Sale of Goods* (1974), para. 1072, and authorities there cited.

<sup>32</sup>*Infra*, ch. 18, sec. 5.

<sup>33</sup>*Infra*, ch. 18, sec. 3; and compare, Draft Bill, s. 8.9.

<sup>34</sup>Compare, *Benjamin's Sale of Goods* (1974), para. 1089.

<sup>35</sup>See, Draft Bill, s. 9.7(5).

<sup>36</sup>UCC 2-702(2) provides as follows:

(2) Where the seller discovers that the buyer has received goods on credit while insolvent he may reclaim the goods upon demand made within ten days after the receipt, but if misrepresentation of solvency has been made to the particular seller in writing within three months before delivery the ten day limitation does not apply. Except as provided in this subsection the seller may not base a right to reclaim goods on the buyer's fraudulent or innocent misrepresentation of solvency or of intent to pay.

<sup>37</sup>UCC 2-702(3). The original version of subsection (3) also applied to lien creditors, and this led to difficulties. See, White & Summers, *Handbook of The Law Under the Uniform Commercial Code* (1972), at pp. 243 *et seq.* The reference to lien creditors was deleted in 1966.

of goods in the seller's hands where the seller becomes insolvent after receiving payment, appears in UCC 2-502. As is noted in a later chapter,<sup>38</sup> UCC 2-502 has negligible practical value, and its constitutionality in a provincial statute may be open to question.<sup>39</sup> While the rights conferred on a seller under UCC 2-702 are somewhat broader, the constitutional difficulty remains. Even in the absence of constitutional considerations, there is the important objection that an unpaid seller's right of reclamation in bankruptcy would introduce an apparently novel principle in Canadian bankruptcy law, the need for which may not be generally conceded.<sup>40</sup> Be that as it may, a provision such as UCC 2-702 is best dealt with in the context of federal bankruptcy legislation and, accordingly, we do not recommend its adoption in the revised Ontario Act. The parties would, of course, be free to enter into a consensual security agreement under *The Personal Property Security Act*.

(5) *Should the Seller's Lien Right Cover Damages or Expenses as well as the Unpaid Price?*

At common law, the seller's lien right was restricted to the unpaid price, and did not extend to expenses incurred by him while detaining the goods.<sup>41</sup> The supporting reason was that the detention was for his own benefit. *The Sale of Goods Act* has not changed this position.<sup>42</sup> The question that needs to be considered is whether the revised Act should do so.

The traditional explanation for denying the seller such an extended lien is not very persuasive. Taken to its logical conclusion, it would also deny a secured seller repossessing the goods on the buyer's default the right to claim a security interest in respect of expenses incurred in relation to his repossession of the goods. The right of the seller to claim such a security interest was recognized in the former Conditional Sales Act<sup>43</sup> and is now recognized in Part V of *The Personal Property Security Act*.<sup>44</sup> Moreover, even at common law, an unpaid seller may have an independent

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<sup>38</sup>*Infra*, ch. 17.

<sup>39</sup>This is because of the federal Parliament's paramount jurisdiction in questions of bankruptcy and insolvency under s. 91(21) of *The British North America Act*, 1867.

<sup>40</sup>The Quebec *Civil Code*, in arts. 1998 and 1999, recognizes the right of an unpaid vendor to revendicate goods within 30 days after delivery, provided certain conditions are met. The *Report of the Study Committee on Bankruptcy and Insolvency Legislation* (Ottawa 1970), sec. 3.2.045, recommended that a similar provision be incorporated in the revised *Bankruptcy Act* for the benefit of unpaid sellers in all provinces in the event of the buyer's bankruptcy. According to information conveyed to us, the recommendation was opposed by important segments of the commercial community and was abandoned. There is no reference to such a right in the revised Bankruptcy Bill, Bill S-11, introduced in the Senate on 21 March, 1978.

<sup>41</sup>*Somes v. The Directors of the British Empire Shipping Co.* (1860), 8 H.L.C. 338, 345, 11 E.R. 459, 462 (H.L.); *Chalmers' Sale of Goods Act* 1893, footnote 26 *supra*, p. 174, n. (i).

<sup>42</sup>*Benjamin's Sale of Goods* (1974), para. 1074.

<sup>43</sup>R.S.O. 1970, c. 76 as am., s. 9(1).

<sup>44</sup>R.S.O. 1970, c. 344 as am., s. 58.

claim for damages arising out of his detention of the goods.<sup>45</sup> The question, therefore, seems to resolve itself into the narrow issue whether the seller should be forced to sue for his expenses, or whether he should be able to use his lien as a vehicle for assuring reimbursement. It has been argued that enlarging the unpaid seller's lien would introduce uncertainty, since the parties may disagree on the amount of the seller's damages, and that it might increase the seller's opportunity for coercive tactics. This might well be true if the seller's lien were extended to include unliquidated damages; but the dangers would be substantially less if the seller's claim were limited to actual out-of-pocket expenses.

Article 60 of the 1977 draft UNCITRAL Convention, following a similar provision in the Uniform Law on the International Sale of Goods,<sup>46</sup> permits the seller to retain the goods until he has been reimbursed his reasonable expenses by the buyer. So, apparently, did the *Uniform Sales Act*.<sup>47</sup> The seller's position is not spelled out as clearly in the Code, but the available evidence points to the same result. By way of comparison, it may be noted that UCC 2-711(3) creates a statutory security interest in favour of a buyer who has rejected non-conforming goods. This statutory security interest covers any expenses reasonably incurred in the inspection, receipt, transportation, and care and custody of the goods, as well as any payment made on their price. Again, UCC 2-706(1) empowers an unpaid seller, exercising his right of resale, to deduct from the proceeds any "incidental damages" incurred by him in relation to the goods. The words "incidental damages" are broadly defined in UCC 2-710 to cover expenses incurred by the seller subsequent to the buyer's breach. It would be anomalous if the seller could deduct his expenses from the proceeds of a resale, but not be entitled to claim them as a condition of releasing the goods to the buyer.

In the light of these precedents, we are of the view that the equities favour an extension of the seller's lien rights. We therefore recommend that, in the revised Act, the seller's right to withhold delivery should include any reasonable expenses in relation to the care and custody, transportation and stoppage of the goods, and other incidental expenses incurred by him subsequent to the buyer's breach or insolvency.<sup>48</sup>

### (iii) *Right of Stoppage in Transitu*<sup>49</sup>

The unpaid seller's right to stop goods in transit is set out in section 42 of *The Sale of Goods Act*, which provides as follows:

42. Subject to this Act, when the buyer of goods becomes insolvent, the unpaid seller who has parted with the possession of the goods has the right of stopping them in transitu, that is to say, he may resume possession of the goods as long as they are in course of transit, and may retain them until payment or tender of the price.

<sup>45</sup>*Benjamin's Sale of Goods* (1974), para. 1074, n. 4. See, also, *The Sale of Goods Act*, s. 36.

<sup>46</sup>Art. 91.

<sup>47</sup>S. 51, last sentence. See, *Williston on Sales* (Rev. ed., 1948), secs. 499, 559.

<sup>48</sup>See, Draft Bill, s. 9.7(2).

<sup>49</sup>See, *The Sale of Goods Act*, ss. 42-45.

The right of stoppage in transit seems to have lost much of its practical importance. The reasons for this decline include the ubiquitous use of documentary letters of credit in international shipments, modern credit checking facilities, and the difficulties of learning of the buyer's insolvency before the goods are delivered to the buyer. We can, therefore, dispose of the right of stoppage quite briefly. As has already been noted, under *The Sale of Goods Act* the right of stoppage only arises where the buyer has become insolvent;<sup>50</sup> mere non-payment of the price, or other forms of breach, are not sufficient. Moreover, by section 43(1), goods must, to be in the course of transit, be delivered to a carrier or other bailee for the "purpose of transmission" to the buyer. The right of stoppage is, therefore, restricted to cases where the goods have been so entrusted to a carrier or other bailee. It is not sufficient to show merely that the goods are in the hands of a bailee.<sup>51</sup> As will be seen, the Code adopts a different approach on both these points. We return to the seller's right of stoppage later in this chapter. Suffice it to say at this juncture that we support the retention of the seller's right of stoppage in the revised Act and, subject to the amendments that are discussed later, so recommend.

#### (iv) *Right of Resale*

Subsections (3) and (4) of section 46 of *The Sale of Goods Act* deal with the seller's right of resale. These provisions read as follows:

46.(3) Where the goods are of a perishable nature or where the unpaid seller gives notice to the buyer of his intention to resell and the buyer does not within a reasonable time pay or tender the price, the unpaid seller may resell the goods and recover from the original buyer damages for any loss occasioned by his breach of contract.

(4) Where the seller expressly reserves a right of resale in case the buyer should make default, and on the buyer making default, resells the goods, the original contract of sale is thereby rescinded, but without prejudice to any claim the seller may have for damages.

Subsection (3) confers a statutory right of resale, and its important features are considered below. Subsection (4) recognizes the seller's power to reserve expressly a right of resale in case of the buyer's default, and deals with the consequences of the exercise of such a right. Similar contractual resale provisions have long been a familiar feature in conditional sale agreements. Prior to the adoption of *The Personal Property Security Act*, their proper characterization, and the right of the conditional seller to sue for a deficiency, gave rise to much difficulty. These questions are now dealt with in *The Personal Property Security Act*, and need not be pursued here.

Section 46(3) is the critical provision and, in its existing form, suffers from numerous shortcomings. Traditionally, the subsection was thought of

<sup>50</sup>"Insolvent" is defined in s. 1(3). Compare, Draft Bill, s. 1.1(1)17.

<sup>51</sup>As we point out later in this chapter, however, this difference may not be significant in the context of the seller's total remedies under the existing Act. See, *infra*, at p. 406.

as providing a statutory mechanism for the realization of the seller's lien interest in the goods. This position finds support in the judgment of Finnemore, J., in *Gallagher v. Shilcock*,<sup>52</sup> but was rejected by the English Court of Appeal in *R.V. Ward Ltd. v. Bignall*.<sup>53</sup> As a result, it now appears to be the law that the effect of a statutory resale is to rescind the contract of sale, and that the essential function of the subsection is to enable the seller to convert what may only be a minor breach of an obligation (the failure to pay) into breach of a condition.<sup>54</sup> The conceptual importance of the provision is, therefore, limited. It should also be noted that the subsection is misleading because it incorrectly suggests that the seller can only exercise a right of resale under the circumstances described in the subsection. It is clear, however,<sup>55</sup> that the seller retains his common law rights to cancel and resell where there has been breach of a condition, whether because of non-payment or breach of any other term of the contract, or, where the buyer has otherwise repudiated the contract.

Subsection (3) is also deficient in the following respects. First, by virtue of its linkage to sections 37 and 38, the statutory right of resale is confined to breaches by the buyer involving payment of the price. Secondly, as mentioned, it is not clear whether it applies to cases where the unpaid seller has retained title to the goods, and this question has given rise to differences of opinion.<sup>56</sup> Again, there is some doubt whether the subsection entitles the unpaid seller to cancel the contract without reselling the goods.<sup>57</sup> Fourthly, subsection (3) fails to indicate whether the seller is entitled to recover a deficiency based on the resale price, or whether the seller's measure of damages is still governed by the market price test enshrined in section 48(3). The consensus appears to be in favour of the market price test.<sup>58</sup> A similar question arises concerning the relationship between section 46(3) and the seller's right to recover the price under section 47 of the Act. The theory of section 46(3) adopted in *R.V. Ward Ltd. v. Bignall*, as the decision itself shows, leads inescapably to the conclusion that, once the right of resale has been exercised, the contract is rescinded and the seller loses his right to sue for the price. Presumably, he also loses the benefit of any judgment he may have already obtained for the price. Many sellers would not regard this as a commercially sound result, and understandably so. In the sixth place, the subsection is silent on the disposition of any surplus proceeds arising from the resale. Finally,

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<sup>52</sup>[1949] 2 K.B. 765.

<sup>53</sup>[1967] 1 Q.B. 534 (C.A.).

<sup>54</sup>It also serves another function; namely, to re-vest title in the seller where title has passed to the buyer. It was no doubt the title considerations that weighed most heavily with the 19th century English courts. Compare, *Williston on Sales* (Rev. ed., 1948), secs. 544-45.

<sup>55</sup>Baer, footnote 1 *supra*, at pp. 34 *et seq*; *Benjamin's Sale of Goods* (1974), paras. 1137 *et seq*. For a contrary view, see, Fridman, *Sale of Goods in Canada* (1973), at p. 333.

<sup>56</sup>See, footnote 22 *supra*, and the text thereto.

<sup>57</sup>The theory of section 46(3) adopted in *R. V. Ward Ltd. v. Bignall*, footnote 53 *supra*, strongly suggests that he can.

<sup>58</sup>Benjamin's view is that the market price test prevails: *Benjamin's Sale of Goods* (1974), para. 1156; and see, also, para. 1238.

section 46(3) provides no guidelines for the conduct or machinery of the resale, so as to protect the buyer against excessive deficiency claims.<sup>59</sup>

The conclusion that emerges from these points is that the role of section 46(3) needs to be reconsidered. In this reassessment two issues should be kept quite separate. The first concerns the circumstances in which the seller should be entitled under the revised Act to treat the buyer's failure to pay as amounting to a substantial breach of the contract. We have dealt with this earlier.<sup>60</sup> The second issue may be stated as follows: assuming the seller is entitled to resell, under what circumstances should he be able to use the results of the resale as proof of his damages, and to sue for any deficiency in the price? As will be seen, UCC 2-706 addresses itself to this issue and, on the whole, we think, answers it very convincingly.

#### (v) *Residual Questions*

Two related questions deserve to be discussed briefly. The first is whether an unpaid seller in possession of the goods should be obliged to exhaust his real remedies before being entitled to sue for the price. It is clear that the existing Act imposes no such duty on the seller. It may be argued that such a rule<sup>61</sup> is consistent with the seller's general duty to mitigate his damages. Whether this analogy is entirely apt is open to question; but it seems to us in any event that the Code has found a more satisfactory solution to the problem. By virtue of UCC 2-709(1) the seller is generally only entitled to sue for the price where the buyer has accepted the goods. As a result, only exceptionally will the seller in possession of the goods be in a position to elect between suing for the price or claiming damages. Later in this chapter, we recommend adoption in the revised Act of a provision comparable to UCC 2-709(1). We do not, therefore, recommend that the revised Act should contain a provision requiring the seller to exhaust his real remedies before being entitled to sue for the price.

The other question is whether the revised Act should extend the seller's right of repossession and resale to cases where the goods have been delivered to the buyer and he has failed to pay; in other words, should the unpaid seller have a statutory non-consensual, non-possessory lien or right of cancellation in respect of the unpaid purchase price? It will be observed that this question raises in a broader form the issue that was considered previously in connection with goods delivered to an *insolvent* buyer. Some legal systems recognize such a right. It is clear, however, that no such right obtains under our law,<sup>62</sup> except where the seller has retained title to, or a security interest in, the goods, where the buyer has been guilty of fraud or misrepresentation, or where the contract has been rescinded by mutual agreement. Where title and possession have passed, the theory appears to be that non-payment by the buyer, or breach of any other

<sup>59</sup>Admittedly, this criticism is only valid if the resale price is in fact binding on the buyer.

<sup>60</sup>See, *supra*, at p. 392.

<sup>61</sup>See, Baer, footnote 1 *supra*, at pp. 44-45.

<sup>62</sup>*Benjamin's Sale of Goods* (1974), para. 1147.

obligation, however serious, cannot unilaterally revest title in the seller. The logic of this conclusion is not obvious since, in other circumstances, the law finds no difficulty in permitting an involuntary retransfer of title. Be this as it may, preoccupation with title concepts diverts attention from the important policy consideration. The point is that rights of repossession and resale after the goods have been delivered to the buyer have a potentially adverse effect on the legitimate expectations of third parties, and should, therefore, only be permitted subject to proper safeguards such as are found in *The Personal Property Security Act*. Moreover, it would be anomalous to confer upon a seller greater rights against a solvent buyer than are available against an insolvent buyer. Our conclusion is, therefore, that the existing position is sound, and we do not recommend the conferment on the seller of a general statutory non-possessory lien right. This recommendation is not, however, intended to derogate from the seller's right to obtain a consensual security interest in accordance with the provisions of *The Personal Property Security Act*.

#### (b) THE CODE POSITION

The Article 2 provisions on real remedies corresponding to those in *The Sale of Goods Act* are to be found in sections 2-702, 2-703, 2-705 and 2-706 of the *Uniform Commercial Code*. UCC 2-702(1) is concerned with the seller's right to withhold or to stop delivery where the buyer is insolvent, and corresponds with existing Anglo-Canadian law. We have dealt earlier in this chapter with UCC 2-702(2). The provisions in UCC 2-703, the Code's index of seller's remedies, have also been referred to previously. UCC 2-705 contains the Code's version of the seller's right of stoppage, while UCC 2-706 is concerned with his right of resale. Of these provisions, those on resale are by far the most important.

##### (i) *The Right to Withhold Delivery*

The right to withhold is the Code's nomenclature for the right of lien or retention conferred under *The Sale of Goods Act*. This right is conferred by UCC 2-703, the index section, but, as we have pointed out, is not further elaborated in other sections of the Code. The Code is able to use a single expression because title concepts play no role in determining the seller's remedies. Hence, it is not necessary to distinguish the situations in which title has passed from those in which it still remains with the seller. We have previously indicated our support for this approach. Equally noteworthy is the fact that Article 2 contains no provisions corresponding to sections 39-41 of the Ontario Sale of Goods Act with respect to the scope and termination of the right to withhold, although such provisions appeared in the *Uniform Sales Act*. Presumably, they were omitted because they were no longer regarded as of practical importance. This is, however, a view that we do not share. Finally, it should be noted that the right to withhold is not restricted in the Code to cases of non-payment or the buyer's insolvency,<sup>63</sup> as is true under *The Sale of Goods Act*, but also

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<sup>63</sup>The right to withhold in the case of the buyer's insolvency is dealt with in UCC 2-702.

extends to the other breaches enumerated in 2-703, notably repudiation by the buyer.<sup>64</sup>

The Commission recommends that, following the Code nomenclature, the seller's lien right should be described in the revised Act as a right to withhold. We also recommend that the seller should be able to withhold delivery of goods in his possession in the following circumstances: (a) until the buyer pays any sum due on or before delivery; (b) until payment of the price where the buyer is insolvent; or, (c) where the buyer repudiates the contract, until retraction of the repudiation as provided in other provisions of the revised Act.<sup>65</sup>

(ii) *Stoppage in Transitu*

The seller's right to stop goods in transit is dealt with in UCC 2-705. This section provides as follows:

2-705.(1) The seller may stop delivery of goods in the possession of a carrier or other bailee when he discovers the buyer to be insolvent (Section 2-702) and may stop delivery of carload, truckload, plane-load or larger shipments of express or freight when the buyer repudiates or fails to make a payment due before delivery or if for any other reason the seller has a right to withhold or reclaim the goods.

(2) As against such buyer the seller may stop delivery until

- (a) receipt of the goods by the buyer; or
- (b) acknowledgment to the buyer by any bailee of the goods except a carrier that the bailee holds the goods for the buyer; or
- (c) such acknowledgment to the buyer by a carrier by reshipment or as warehouseman; or
- (d) negotiation to the buyer of any negotiable document of title covering the goods.

(3) (a) To stop delivery the seller must so notify as to enable the bailee by reasonable diligence to prevent delivery of the goods.

- (b) After such notification the bailee must hold and deliver the goods according to the directions of the seller but the seller is liable to the bailee for any ensuing charges or damages.
- (c) If a negotiable document of title has been issued for goods the bailee is not obliged to obey a notification to stop until surrender of the document.

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<sup>64</sup>Repudiation here appears to refer to anticipatory repudiation of the buyer's obligations, and must be read in conjunction with the provisions in UCC 2-610 and 2-611. See, further, *infra*, ch. 18, sec. 4.

<sup>65</sup>See, Draft Bill, s. 9.7(1).

- (d) A carrier who has issued a non-negotiable bill of lading is not obliged to obey a notification to stop received from a person other than the consignor.

UCC 2-705 reproduces the essence of the common law concept of stoppage *in transitu*, but extends it in one, and possibly two, respects.<sup>66</sup> First, at least in the case of the buyer's insolvency, the right of stoppage is no longer limited to situations where the goods are delivered to a carrier or other bailee "for the purpose of transmission" to the buyer, as is true under the Ontario Act. Under the Code provision, the right of stoppage applies wherever the goods are "in the possession" of a carrier or other bailee,<sup>67</sup> whether or not for purposes of transmission. However, it seems doubtful whether the Code has effected a change in substance. At common law, where at the time of sale the goods were in the possession of a bailee, there was no deemed delivery by the seller to the buyer, and therefore no transfer of possession, unless and until the bailee attorned to the buyer, or the buyer was supplied with a document of title that had the effect of transferring possession of the goods to the buyer. This rule is essentially re-enacted in section 29(3) of the Ontario Sale of Goods Act.<sup>68</sup> It follows that, under existing Ontario law, until either of these events has occurred the seller retains his lien rights as an unpaid seller.<sup>69</sup> The seller does not have to rely on his right of stoppage; in fact, it cannot arise because the goods are not in transit to the buyer.

The Code appears to have changed the prior law by the introduction of the provisions of UCC 2-503(4). This subsection provides, *inter alia*, that, where the goods are in the possession of a bailee and are to be delivered without being moved, tender to the buyer of a non-negotiable document of title, or of a written direction to the bailee to deliver, is sufficient tender unless the buyer seasonably objects. Formal attornment by the bailee is not necessary. The effect of such a tender would be that the seller loses his right to withhold delivery under UCC 2-703(a), since delivery will be deemed to have taken place upon acceptance of the tender. Consequently, the seller may be obliged to rely upon the Code's extended right of stoppage under UCC 2-705. Assuming this analysis to be correct,<sup>70</sup> the net effect of the Code provisions is simply to reduce the scope of the seller's lien right in favour of an enlarged right of stoppage.

Ordinarily, there would be little point in making the same change to the revised Ontario Act. However, we have previously recommended adoption of a provision similar to UCC 2-503(4).<sup>71</sup> In recommending adoption of this provision, it was not our intention to reduce the overall benefit of

<sup>66</sup>Compare, NYLRC Study, ch. 5, footnote 52, *supra*, at p. (557); Duesenberg and King, *Sales and Bulk Transfers Under the Uniform Commercial Code*, Bender's Uniform Commercial Code Service, Vol. 3A, at p. 13-14, s. 13.03[3]; Vold, *Law of Sales* (2nd ed., 1959), at p. 258, n. 2.

<sup>67</sup>UCC 2-705(1).

<sup>68</sup>Compare, *Benjamin's Sale of Goods* (1974), para. 591; Vold, footnote 66 *supra*, at pp. 250-51.

<sup>69</sup>Benjamin, *supra*, para. 1082.

<sup>70</sup>The textwriters do not discuss the point; nor does it appear to have arisen in the few reported cases under UCC 2-705(1).

<sup>71</sup>*Supra*, ch. 14, sec. A.3(a)(ii).

the real remedies available to the unpaid seller. Accordingly, we recommend the extension of the seller's right of stoppage in the revised Act to all cases where the goods are in the possession of a carrier or other bailee, whether or not for the purpose of transmission to the buyer.<sup>72</sup>

The other difference between UCC 2-705(1) and the right of stoppage in the Ontario Act is that, under the Code, and subject to the qualification noted below, the right is not confined to the buyer's insolvency. It also arises, at least where the goods are in the hands of a carrier and involve a larger shipment, when the buyer repudiates, fails to make a payment due before delivery, "or if for any other reason the seller has a right to withhold or reclaim the goods". We support this extension of the grounds upon which the right of stoppage may be exercised. In our view, they should, so far as practicable, be the same as in the case of the right to withhold. According to our information, rights of stoppage are exercised very rarely and, if the reactions of one large national carrier are a reliable guide, it seems unlikely that the Code's expanded right of stoppage would encounter much opposition in Ontario. Accordingly, we recommend that, under the revised Act, the seller should be able to stop goods in transit not only where the buyer is insolvent but also where the buyer has repudiated, fails to make a payment due before delivery, or if for any other reason the seller has a right to withhold or reclaim the goods.

Under the Code, in non-insolvency cases, the right of stoppage only applies to a delivery of "carload, truckload, planeload or larger shipments of express or freight".<sup>73</sup> The question, therefore, arises whether the right of stoppage in non-insolvency cases should be similarly restricted under the revised Ontario Act to larger shipments of freight. Official Comment No. 1 to UCC 2-705 explains that the restriction was imposed in order to limit the hardship to which carriers would otherwise be exposed. Since the carrier would be entitled to recover any "ensuing charges or damages" incurred by him in following the seller's instructions,<sup>74</sup> the size of the shipment is not likely to make much difference to him. We, therefore, recommend that, unlike the rule in UCC 2-705, the seller's right to stop goods in transit should not be limited under the revised Act to larger shipments of freight, whether or not the buyer is insolvent. We have accordingly eliminated this distinction in our recommended version of UCC 2-705(1).<sup>75</sup>

Before leaving UCC 2-705(1), attention should also be drawn to an important ambiguity that needs to be resolved. A literal reading of the subsection leads to the inference that the right of stoppage in non-insolvency cases only applies where the goods are in the hands of a carrier, and not where goods are held by a non-carrier bailee. This is because one does not normally associate "larger shipments of express or freight" with a bailee who is not a carrier. It seems unlikely, however, that the draftsmen intended to draw such a distinction and, in our view, it would be an untenable distinction. It seems more likely that the draftsmen intended to confer the extended right of stoppage without restriction as to the size of the consign-

<sup>72</sup>See, Draft Bill, s. 9.8(1).

<sup>73</sup>UCC 2-705(1).

<sup>74</sup>See, UCC 2-705(3)(b).

<sup>75</sup>See, Draft Bill, s. 9.8(1).

ment where the goods are held by a non-carrier bailee, and to restrict the right of stoppage to cases involving larger shipments where the goods are in the hands of a carrier. This would make sense since, from a bailee's point of view, it is more troublesome to stop goods in transit than to stop delivery of goods that are simply lying in a warehouse. In any event, whether or not we are right in our construction of the Code's intention,<sup>76</sup> we are of the view that the extended right of stoppage should apply to all types of bailee, and we so recommend.

### (iii) *Right of Resale*

UCC 2-706 deals with the seller's right of resale. Subsection (1) of the Code provision reads as follows:

2-706.(1) Under the conditions stated in Section 2-703 on seller's remedies, the seller may resell the goods concerned or the undelivered balance thereof. Where the resale is made in good faith and in a commercially reasonable manner the seller may recover the difference between the resale price and the contract price together with any incidental damages allowed under the provisions of this Article (Section 2-710), but less expenses saved in consequence of the buyer's breach.

UCC 2-706 permits a seller who resells goods in good faith and in a commercially reasonable manner to measure his damages, not by the market price test, but with reference to the difference between the resale price and the contract price. The single most important feature, therefore, about the seller's right of resale under the Code is that it is not conceived of simply as a vehicle for realizing the unpaid seller's lien rights. Rather, the primary function of the section is to provide a convenient mechanism for measuring the seller's damages.<sup>77</sup> UCC 2-706 applies<sup>78</sup> whenever the buyer has been guilty of one of the breaches enumerated in UCC 2-703, and the seller has not delivered, or is deemed to have resumed possession of, the goods.<sup>79</sup>

This change in role is to be welcomed. It emphasizes the underlying unity of the problems that arise upon the buyer's breach, regardless of the particular character of the breach or the locus of title, factors that are important under the Ontario Sale of Goods Act. Unlike section 46(3), the Code's resale provisions also provide some basic, yet flexible, guidelines for the exercise of the seller's right. The dominant theme is that the seller must proceed in a commercially reasonable manner.<sup>80</sup> If he satisfies this

<sup>76</sup>Once again, the case law to date throws no light on the question.

<sup>77</sup>See, NYLRC Study, ch. 5, footnote 52, *supra*, at p. (559).

<sup>78</sup>UCC 2-706(1), 1st sent.

<sup>79</sup>The goods need not be identified to the contract at the time of the buyer's breach (see, UCC 2-706(2), 3rd sent.). Hence, UCC 2-706(1) carefully provides that the seller "may resell the goods concerned or the undelivered balance thereof". There is no specific requirement in s. 2-706 that, in the case of identified goods, the goods must be in the seller's possession at the time of resale, but this inference is to be drawn from the list of breaches enumerated in UCC 2-703. The same question arises in construing the seller's right to cancel under UCC 2-703(f). See Nordstrom, *Handbook of the Law of Sales* (1970), sec. 165, especially at pp. 498-99.

<sup>80</sup>UCC 2-706(1), 2nd sent.

test and the more particularized rules set forth in the section, the seller is entitled to recover any deficiency in the contract price.<sup>81</sup> He is not, however, accountable for any surplus<sup>82</sup> since the draftsmen implicitly rejected any suggestion that the seller is merely acting as the buyer's agent in effecting the resale.<sup>83</sup>

An important innovation, found in UCC 2-706(2), is that the seller's resale right is not restricted to goods identified to the contract, as is the case under section 46(3) of *The Sale of Goods Act*, or indeed even to goods in existence at the time of the buyer's breach. The provisions in UCC 2-706(2) must be read in conjunction with the provisions in UCC 2-704, which deal with the various alternatives open to a seller faced with a repudiating buyer in cases where the goods are unfinished or have not been identified at the time of the contract. Once again, the absence of a requirement that goods be identified to the contract emphasizes the very different conceptual role of the resale provisions in UCC 2-706, from the role played by section 46(3) of *The Sale of Goods Act*, which was traditionally viewed as providing a statutory mechanism for the realization of the seller's lien interest in the goods.

We support the principle of UCC 2-706 and, subject to clarification of a number of points discussed hereafter, recommend the adoption in the revised Act of a comparable provision.<sup>84</sup> It should be carefully noted that our section indexing the seller's remedies<sup>85</sup> provides that the right of resale is available to a seller only where the buyer's conduct amounts to a substantial breach.

The points requiring clarification are as follows. In the first place, it is not clear whether the seller is bound by the results of a resale in claiming damages, or whether he may ignore the resale and elect instead to claim damages as measured under the provisions of UCC 2-708, which employs a market price test.<sup>86</sup> The commentators are divided<sup>87</sup> on the

<sup>81</sup>*Ibid.*

<sup>82</sup>UCC 2-706(6). The rule does not apply to a "person in the position of a seller" exercising his rights under UCC 2-707, or to a buyer exercising his lien rights under UCC 2-711(3). They are accountable for any excess.

<sup>83</sup>UCC 2-706, Comment 11. The same rule was adopted in s. 60(1) of the *Uniform Sales Act*: see, *Williston on Sales* (Rev. ed., 1948), sec. 553, n.9.

<sup>84</sup>See, Draft Bill, s. 9.9.

<sup>85</sup>*Ibid.*, s. 9.3.

<sup>86</sup>UCC 2-708(1) corresponds with section 48(3) of the Ontario Sale of Goods Act, and reads as follows:

2-708.(1) Subject to subsection (2) and to the provisions of this Article with respect to proof of market price (Section 2-723), the measure of damages for non-acceptance or repudiation by the buyer is the difference between the market price at the time and place for tender and the unpaid contract price together with any incidental damages provided in this Article (Section 2-710), but less expenses saved in consequence of the buyer's breach.

The market price test is further discussed *infra*, chapter 18, sec. 2.

<sup>87</sup>For example, White & Summers, footnote 37 *supra*, pp. 222-24; Peters, "Remedies for Breach of Contracts Relating to the Sale of Goods under the Uniform Commercial Code: A Roadmap for Article Two" (1963), 73 Yale L.J. 199, at pp. 260-61. A similar question arises with respect to the buyer's right to cover under UCC 2-712. See *infra*, ch. 17, sec. D.3(c).

issue, although there is substantial historical evidence that the Code draftsmen envisaged the right of resale enuring only for the seller's benefit. To permit the seller to ignore the results of the resale and to claim damages based on the difference between the market price and contract price could, however, lead to undesirable consequences. It could provide the seller with an unjustifiable windfall, thus violating the general principle in UCC 1-106 that the object of the Code's remedial provisions is to put an aggrieved party in the same position as if the other party had fully performed. It could also leave the buyer in an uncertain state. UCC 2-706 requires the seller to give the buyer notice of his intention to resell and, in the case of a public sale, of the time and place of the sale. It would be pointless for the buyer to attend the sale, or to take other protective steps, if he had no assurance that the seller would be bound by the results of the sale.

In the Commission's opinion, where a seller has exercised his right of resale, he should be bound by the results of the resale in claiming his damages, and we so recommend. To ensure this result, the recommended general provision in the revised Act dealing with the computation and measure of the seller's damages should provide that, where the seller resells, he is not entitled to sue for the difference between the contract price and the price that we later recommend for adoption in lieu of the market price, if his actual loss is less than this difference.<sup>88</sup> Some of the implications of this restatement of the compensatory principle of contract damages are examined later in this chapter; suffice it to say for the moment that it is broad enough to answer the problem at hand. Implicit, also, in this recommendation is our rejection of the concept that the market price test provides a liquidated measure of damages which the seller (and, in a converse case where the seller is in breach, the buyer) should be entitled to recover as a statutory minimum.

A second point requiring clarification arises because UCC 2-706 fails to spell out clearly the consequences of non-compliance by the seller with the requirements of the section. It emerges from subsection (1) of UCC 2-706 that the seller is not entitled to recover the difference between the resale price and the contract price, unless the resale is made in good faith and in a commercially reasonable manner. These requirements do not, however, encompass the effect of breach of the additional duties imposed upon the seller in subsections (2) and (3). Official Comment 2 states ambiguously that "[f]ailure to act properly under this section deprives the seller of the measure of damages here provided and relegates him to that provided in Section 2-708". Assuming that the draftsmen's intention was that the seller should be denied the benefit of the resale provisions, regardless of the importance of the seller's breach of these additional duties or of the

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<sup>88</sup>See, Draft Bill, s. 9.10(4)(a). Compare, 1977 draft UNCITRAL Convention, Article 58, which only entitles a party to claim damages on a market price differential basis if he has not made a purchase or resale pursuant to Article 57. See, also, ch. 18, sec. 2, *infra*, where we recommend that the revised Act adopt a test of 'commercially reasonable purchase or disposition' in lieu of the market price test.

prejudice occasioned to the buyer,<sup>89</sup> this could penalize the seller unfairly for trivial violations of the statutory standards. To meet these difficulties, we make two recommendations. First, the provision in the revised Act comparable to UCC 2-706 should contain simplified resale requirements. Secondly, we recommend that the seller should be deprived of his right to sue for damages under this provision only when he "does not resell in a commercially reasonable manner".<sup>90</sup> These modifications should avoid the literalism that marred the interpretation of the resale provisions in the now repealed Conditional Sales Act,<sup>91</sup> and should focus attention on the important operational features of the statutory right of resale.

A number of other matters arising out of UCC 2-706 require discussion. We deal at a later stage in this chapter with the seller's right to claim additional or alternative damages under UCC 2-708(2), or otherwise, where his deficiency claim under UCC 2-706 is not sufficient to put him in as good a position as performance would have done. At this juncture, we discuss three important issues: namely, the buyer's right to cure; notice of resale; and, the buyer's entitlement to any surplus proceeds of a resale.

### *(1) Buyer's Right to Cure*

The question<sup>92</sup> arises whether, where the seller has a right of resale, the buyer should be entitled to reinstate the contract upon tendering the purchase price. It is not clear whether the mere exercise of the seller's right of resale amounts to an automatic cancellation. An actual resale obviously must do so, but it is uncertain whether the same consequences will be ascribed to any preliminary steps towards a resale taken by the seller.<sup>93</sup> The question is significant because it may affect the buyer's right to purge his breach before the resale actually takes place. Should preliminary steps amount to a cancellation, presumably the buyer will be too late to purge his breach; although it may be that, in a subsequent deficiency claim, the buyer might be able to argue successfully that the seller failed to mitigate his loss in not accepting the buyer's offer. However, this reasoning will not assist the buyer where the seller is not claiming damages. Only a right to cure, comparable to the right to cure conferred on the seller under UCC 2-508 where the seller has delivered non-conforming goods, would provide relief to the buyer. No such cure is conferred by UCC 2-706. An obvious question is whether the buyer should be afforded the right to cure his breach under the revised Act.

A majority of the Commission has decided not to recommend the

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<sup>89</sup>The position appears to be unclear. Compare, White & Summers, footnote 37 *supra*, at p. 218, and cases there cited in n. 27.

<sup>90</sup>Draft Bill, s. 9.9(6).

<sup>91</sup>The case law is reviewed in Giles, "Conditional Sales Deficiency Notices" (1960), 9 Chitty's L.J. 210, 261.

<sup>92</sup>Compare, Baer, footnote 1 *supra*, at pp. 70-71, 77-79, 93-94.

<sup>93</sup>A similar question has been much litigated in the conditional sales area where a repossessing seller has sought to sue for the balance of the price and the buyer has argued that the sale had been rescinded because of the seller's unauthorized dealings with the goods after repossession.

adoption of such a feature in the revised Act. Our reasons are as follows. In the first place, no compelling case has been made for a buyer's right to cure and, if such a right were to be introduced, it would have to be made available not only where a seller intends to resell, but also in other cases where the seller has exercised a right to cancel the contract because of the buyer's breach. Secondly, the recommended restriction in the revised Act of the seller's right to cancel to cases where the buyer has committed a substantial breach<sup>94</sup> already affords reasonable protection to the buyer. In practice, it would not seem to be in the seller's interest to cancel precipitously; various warnings will usually be given to the buyer before the seller makes his election to cancel. Again, there are important differences between a seller's right to cure in the case of non-conforming goods under UCC 2-508, and the right sought to be conferred on the buyer. The seller's right to cure under the *Uniform Commercial Code* is heavily circumscribed, and is primarily designed to mitigate the rigours of the perfect tender rule. In our remedial scheme, the buyer is not faced with a strict performance rule, except where his breach causes significant prejudice to the seller. Finally, a non-conforming seller has, as a general rule, a much heavier stake in a right to cure than a defaulting buyer. The buyer's duties are usually simple and easy to comply with. The seller's duties, on the other hand, are much more onerous and subject to many imponderables. In particular, defects in goods are often latent, and may not come to light until after the goods have been delivered and tested. Hence, there are sound commercial reasons for allowing the seller a right to cure, reasons that do not obtain in favour of a buyer's right to cure where he has committed a substantial breach. Accordingly, we do not recommend<sup>95</sup> that, where the seller has exercised a right of resale or cancellation, the buyer should be entitled to cure his breach and thereby to reinstate the contract.

## (2) Notice of Resale

A question that has given us some difficulty is whether a seller who is seeking to rely on the results of a resale to quantify his damages, should be obliged to give prior notice of his intention to resell. Persuasive arguments can be made both in favour of and against such a requirement. UCC 2-706 imposes such an obligation. A further analogy is provided in Ontario by the resale provision in the former Conditional Sales Act<sup>96</sup> and, now, by section 58 of *The Personal Property Security Act*. It is true that section 46(3) of *The Sale of Goods Act* also requires the seller to give notice of his intention to resell; but it appears that the sole purpose of this requirement is to enable the buyer to cure the default, not to monitor the resale.<sup>97</sup>

<sup>94</sup>See, Draft Bill, s. 9.3(2).

<sup>95</sup>One of the Commissioners, the Honourable Richard A. Bell, does not concur in this recommendation. He would accord the buyer a right to cure and reinstate the contract. Obviously, if this position were adopted, a notice requirement would be mandatory.

<sup>96</sup>R.S.O. 1970, c. 76 as am., s. 9.

<sup>97</sup>This is brought out clearly in s. 60 of the *Uniform Sales Act*. S.60(3) provided that notice of an intention to resell was not essential to the validity of the resale but that "the giving or failure to give such notice shall be relevant in any issue involving the question whether the buyer had been in default an unreasonable time before the resale was made".

The objection to a notice requirement in a resale provision of the kind contained in UCC 2-706 rests on several grounds. One ground is that it is not clear what such a notice is designed to accomplish. It cannot be to afford the buyer an opportunity to reinstate the contract because, as has been seen, no such right is conferred under UCC 2-706. Presumably, its purpose is to allow the buyer to monitor the resale in order to satisfy himself that the seller is proceeding in a commercially reasonable manner; or alternatively, in the case of a public sale, to participate in the bidding. However, this goal cannot readily be accomplished under the Code provision. In the case of a private sale, the seller is only required to give reasonable notification of his intention to resell; it is not clear that this includes a requirement to provide particulars of any prospective private sale. Further, it should be noted that no duty of notification is imposed on a buyer who seeks to "cover" a seller's failure to deliver under the corresponding provisions of UCC 2-712, the reason presumably being that no viable monitoring role was seen in such circumstances. Moreover, since the buyer usually has no "equity" in the goods, and no right under the Code provisions to claim any surplus proceeds arising from the resale, his incentive to police the resale is negligible. On the other hand, a seller who inadvertently fails to give notice of the resale, gives an inaccurate notice, or sends it to the wrong address, may find himself deprived of the right to rely on the results of the resale.

In the light of these considerations, a majority of the Commission has concluded that there is not a sufficiently cogent case to support a mandatory notice requirement. Accordingly, we do not recommend<sup>98</sup> that the revised Act should require the seller to give notice of his intention to resell. We should emphasize, however, that deletion of this feature of UCC 2-706 will not affect the seller's obligation to proceed in a commercially reasonable manner; nor, of course, will it preclude the buyer from subsequently showing that the seller failed to meet this statutory test.

### (3) *Buyer's Entitlement to Surplus Proceeds*

A seller who exercises his right of resale may realize an amount greater than the contract price. As we have seen, UCC 2-706 does not entitle the buyer to claim the surplus proceeds; nor is such a right conferred upon a buyer under Anglo-Canadian law. The question that arises is whether this rule should be changed. The question may be viewed from two perspectives. The first focuses on the particular equities of the issue. The second sees it as part of the larger question of the extent to which the rights and remedies of a seller in a cash transaction should be assimilated to those of a secured seller.<sup>99</sup>

Section 59 of *The Personal Property Security Act* entitles the debtor under a security agreement, including, of course, a conditional sale agree-

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<sup>98</sup>The Honourable J. C. McRuer and Mr. William R. Poole do not concur in this recommendation and would support a mandatory notice requirement; and see, also, footnote 95 *supra*.

<sup>99</sup>Compare, Baer, footnote 1 *supra*, at pp. 131 *et seq.*

ment, to receive the surplus proceeds. If the two cases are similar in substance, consistency suggests that the buyer in a cash transaction should be treated in the same way. However, it is doubtful whether this analogy is entirely apt. The debtor in a secured sale is regarded as the beneficial owner of the goods, and the interest of the seller is limited to a security interest. The debtor, moreover, will usually have made some payments, and the surplus rule is one way, albeit not often a successful way, of protecting his investment. In a cash sale, on the other hand, if one ignores the metaphysics of title, a buyer who is seriously in default before the goods have been delivered to him does not usually regard himself as having an interest in the goods, and other means are available to prevent the forfeiture of any payments he may have made on account.<sup>100</sup> In addition, the imposition of chattel security rules on cash sales would introduce an undesirable element of rigidity in a form of transaction that is usually characterized by great informality. We do not, therefore, think that either logic or functional considerations dictate that cash and credit sellers should be placed on the same footing.

This conclusion does not, however, entirely dispose of the problem. Even if the chattel security analogy is inappropriate, it may still be argued that, since the buyer in a cash sale will be liable for any deficiency after a resale (or what amounts to the same thing, to a claim for damages to cover the seller's loss), the converse should also hold true. But this argument proves too much, for it would lead to the conclusion that, whenever the seller is better off after a breach than he was before, he should be accountable to the buyer. No one has ever suggested such a far-reaching rule. On the contrary, the common sentiment seems much more likely to be that a defaulting buyer should not benefit from his own wrong. This will be particularly true, as it will often be true if our later recommendations are adopted,<sup>101</sup> where the seller has no right to sue for the price and is forced to exercise his real remedies. An alternative argument in favour of a surplus rule is that such a rule might discourage the cash seller from reselling precipitously where the buyer is in default, in order to take advantage of a favourable swing in the market. We do not regard this as a serious danger; but, even if we are wrong, this exceptional situation would not be sufficient, in our view, to justify a change in the rule. In a rising market, the buyer would have every incentive to perform. In addition, the prerequisite of substantial breach and the requirement of good faith will usually preclude the seller from acting hastily. Our conclusion is, therefore, that the rule adopted in UCC 2-706, and now also obtaining under section 46(3) of the Ontario Act as a result of the decision in *R. V. Ward Ltd. v. Bignall*,<sup>102</sup> is sound and should not be changed. Accordingly, we recommend that a seller who has exercised his right of resale should not be accountable to the buyer for any surplus.

### 3. PERSONAL REMEDIES

The two remedies that will be considered under this heading are the

<sup>100</sup>*Infra*, this chapter, sec. 3.

<sup>101</sup>*Ibid.*

<sup>102</sup>[1967] 1 Q.B. 534 (C.A.).

seller's right to sue for the price and his right to damages. His right to cancel has already been considered<sup>103</sup> in connection with our recommended index section of the seller's remedies,<sup>104</sup> and need not detain us any further. The impact of penalty clauses and the doctrine of forfeiture of payments will be considered separately in a later part of this chapter.

#### (a) ACTION FOR THE PRICE

Section 47 of *The Sale of Goods Act* deals with an action by the seller to recover the price of goods sold. This section provides:

47.(1) Where, under a contract of sale the property in the goods has passed to the buyer and the buyer wrongfully neglects or refuses to pay for the goods according to the terms of the contract, the seller may maintain an action against him for the price of the goods.

(2) Where under a contract of sale the price is payable on a day certain, irrespective of delivery, and the buyer wrongfully neglects or refuses to pay the price, the seller may maintain an action for the price although the property in the goods has not passed and the goods have not been appropriated to the contract.

Section 47(1) only entitles the seller to claim the price where the property in the goods has passed to the buyer. An exception to this rule is made in subsection (2) where, under the contract, the price is payable on a day certain. This provision, however, mitigates only slightly the theoretical and practical objections to the principal rule.

As has been noted in chapter 11, the emphasis that the Ontario Sale of Goods Act places on the location of title can lead to arbitrary results, which are equally unsatisfactory from the seller's and buyer's points of view. From the buyer's point of view, if the contract involves a sale of specific goods and the goods are in a deliverable condition, title will usually pass to the buyer without his further assent.<sup>105</sup> The seller will, accordingly, be able to sue for the price, even though the goods are still under his full control and could be resold by him without difficulty. The buyer's refusal to accept the goods does not deprive the seller of his right to the price. If, on the other hand, the contract involves a sale of future or unascertained goods, the buyer can effectively frustrate the seller's attempt to transfer title by failure to cooperate.<sup>106</sup> The buyer can thereby deny the seller the right to claim the price, even though the goods have been manufactured to the buyer's specifications and there is no alternative market for them.<sup>107</sup> An equally unsatisfactory result could ensue if a contract for the sale of

<sup>103</sup>See, *supra*, this chapter, sec. 1.

<sup>104</sup>See, Draft Bill, s. 9.3(2)1.

<sup>105</sup>*The Sale of Goods Act*, s. 19, Rule 1. Compare, *R. V. Ward Ltd. v. Bignall*, [1967] 1 Q.B. 534 (C.A.).

<sup>106</sup>Compare, *Colley v. Overseas Exporters*, [1921] 3 K.B. 302.

<sup>107</sup>*The Sale of Goods Act* contains no provision comparable to s. 63(3) of the *Uniform Sales Act*, which entitled the seller to sue for the price, even though the property in the goods had not passed, where the goods could not readily be resold for a reasonable price. For the history of the provision see, *Williston on Sales* (Rev. ed., 1948), secs. 560 *et seq.*

specific goods contains a clause retaining title in the seller until payment, and there is no provision in the contract requiring the buyer to make payment on a day certain.<sup>108</sup>

The case, therefore, for changing section 47 of the Ontario Sale of Goods Act in favour of a functionally oriented rule is very strong, and UCC 2-709(1) appears to provide the appropriate solution. Subsection (1) reads as follows:

2-709.(1) When the buyer fails to pay the price as it becomes due the seller may recover, together with any incidental damages under the next section, the price

- (a) of goods accepted or of conforming goods lost or damaged within a commercially reasonable time after risk of their loss has passed to the buyer; and
- (b) of goods identified to the contract if the seller is unable after reasonable effort to resell them at a reasonable price or the circumstances reasonably indicate that such effort will be unavailing.

It will be noted that acceptance of the goods by the buyer is a key concept in the application of this section. UCC 2-709(1) only allows the seller to sue for the price where (apart from loss of or damage to conforming goods within a reasonable time after the risk of loss has passed to the buyer) the buyer has accepted the goods, or where, in the case of identified goods, the seller is unable to resell the goods at a reasonable price. In all other cases, the seller is remitted to a claim for damages. The theory of the section is<sup>109</sup> that the seller is usually in a better position to dispose of unwanted goods than the buyer, and that it is economically wasteful to force goods on an unwilling buyer.<sup>110</sup> The effect of subsection (1)(b), which applies where the goods have not been accepted by the buyer, is to recognize an important exception to the rule where there is no reasonable alternative market for the goods. In such a case, the seller is entitled to sue for the price.<sup>111</sup> It will be observed that the effect of UCC 2-709(1) is to place the seller's right to sue for the price where the goods have not been accepted on the same conceptual footing as the buyer's right to seek specific performance of the seller's obligations:<sup>112</sup> in each case, the Code remedy is restricted to circumstances in which damages would not be an adequate remedy. The practical application of UCC 2-709(1) may be tested against the examples of the operation of the present position under the Ontario

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<sup>108</sup>We do not pause to consider here whether s. 47 of *The Sale of Goods Act* is exhaustive of the seller's right to sue for the price. On this point, see *Benjamin's Sale of Goods* (1974), paras. 1193-94.

<sup>109</sup>*Supra*, ch. 11, sec. 2(e).

<sup>110</sup>ULIS, Art. 61(2), contains a provision similar to UCC 2-709(1) (b), but it has been omitted in the 1977 draft UNCITRAL Convention: see Arts. 43(1), 44.

<sup>111</sup>Compare, *supra*, footnote 107.

<sup>112</sup>UCC 2-716.

Sale of Goods Act, mentioned earlier. The differences are striking. Under the Code rule it no longer matters whether or not the goods are identified at the time of contracting, or whether the seller's attempt to pass title has been frustrated by the buyer or by some other circumstance. The only relevant questions are whether the buyer has accepted the goods and, if he has not, whether there is an available market for them. Title considerations become irrelevant.

We support the thrust of UCC 2-709. We appreciate that it can be argued that the Code swings the pendulum too far in the buyer's favour, and that, at least in some circumstances, the seller should be able to sue for the price even though the goods have not been accepted by the buyer. For example, there may be concern<sup>113</sup> about the inadequacy of remitting the seller to a claim for damages and the dilemma that may confront him where the goods are rejected at a distant place. We believe, however, that these apprehensions can be satisfactorily answered.<sup>114</sup> So far as the first point is concerned (the inadequacy of damages), at least in theory the Code's damage provisions, like those in *The Sale of Goods Act*, attempt to make the seller whole. The real issue is whether it is the seller or the buyer who should have the burden of disposing of the goods. The Code answers this question in terms of a balance of convenience. It may be argued that a wrongly rejecting buyer does not deserve much sympathy; but this proves too much. The argument could lead to the seller's being entitled to sue for the price even where the goods are still in his possession, and this would be even more favourable to him than the present law. So far as the second point is concerned (the rejection of goods at a distant place), UCC 2-603 comes to the seller's assistance by requiring the buyer's co-operation in disposing of the goods where the seller has no agent or place of business at the market of rejection. It is also reasonable to expect that, in such a case, a court will be more inclined to find that the goods are not readily resaleable than would be the case where the goods have never left the seller's premises.

These remarks are not intended to convey the impression that UCC 2-709(1) has found the complete solution to a difficult problem. We note, however, that American commentators do not appear to have opposed the Code provisions,<sup>115</sup> and our own inquiries lead us to believe that the reaction of Ontario businessmen is not likely to be very different.<sup>116</sup> We believe that the Code scheme is easier to apply than, and probably superior to, any alternative rule or rules that may be suggested. Accordingly, we

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<sup>113</sup>See, Crawford, Research Paper No. IV.1, at pp. 41-42.

<sup>114</sup>Compare, Baer, footnote 1 *supra*, at pp. 86-88.

<sup>115</sup>See, for example, the mild and predominantly technical comments in NYLRC Study, ch. 5, footnote 52, *supra*, at pp. (563)-(566).

<sup>116</sup>The experienced house counsel of a major Canadian manufacturer advised the Research Team that his company will normally accept the return of unwanted goods of a standard kind, whether the rejection is rightful or not, and this practice appears to be confirmed at least to some extent by the results of the CMA Questionnaire and Mr. Munson's interviews: Fisher, Research Paper No.

recommend that the revised Ontario Act should adopt a provision similar to UCC 2-709 in place of section 47 of the existing Act.<sup>117</sup>

UCC 2-709 is not, however, free of difficulties.<sup>118</sup> It is clear that a buyer will not be deemed to have accepted the goods where he has made a procedurally "effective", albeit substantively wrongful, rejection.<sup>119</sup> This result emerges from the definition of acceptance in UCC 2-606(1)(b) and the provisions of UCC 2-709(3) and 2-703. The position of a buyer who attempts a wrongful revocation of acceptance is less certain. UCC 2-709(3) and UCC 2-703 appear to treat this as sufficient to defeat the seller's claim for the price, but such a literal reading is inconsistent with Comment 5 to UCC 2-709, and with the structure of UCC 2-608. American commentators have argued<sup>120</sup> on policy grounds that a buyer should not be able to revoke his acceptance wrongfully. If this position is accepted as sound, as we believe it is, the Ontario version of UCC 2-709 should avoid the ambiguous language of its American source. Accordingly, we recommend that the provision in the revised Act comparable to UCC 2-709 should make it clear that the seller may recover the price due where goods have been accepted, unless the buyer has justifiably revoked his acceptance.<sup>121</sup>

#### (b) DAMAGES

The rules governing the seller's right to damages appear in sections 48 and 52 of the Ontario Sale of Goods Act. These sections read as follows:

48.(1) Where the buyer wrongfully neglects or refuses to accept and pay for the goods, the seller may maintain an action against him for damages for non-acceptance.

(2) The measure of damages is the estimated loss directly and

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I.2, pp. 35-44 (variation of terms and cancellation of contracts); Munson, Research Paper No. I.3, pp. 17, 43-47. (These sources do not distinguish between cancellation of contract before and after delivery, and the data must therefore be treated with caution. What they do appear to show is that a buyer's wish to return unsold inventory because he has overbought or to cancel before delivery because he cannot finance the purchase, is more important than rejection of tendered goods on grounds of alleged non-conformity. Here, as in other areas, different groups of businessmen may take different positions. A large supplier or retail store concerned about its image, and having an alternative outlet for a cancelled order or wrongfully rejected goods, may accept the Code rules more readily than a small supplier or retail store. But even in the latter case a lawyer is likely to advise his client that a quick settlement will cost him less than a protracted and unpredictable law suit.)

<sup>117</sup>See, Draft Bill, s. 9.11(1).

<sup>118</sup>See, White & Summers, footnote 37 *supra*, at pp. 210-13.

<sup>119</sup>*Ibid.*, at pp. 211-13.

<sup>120</sup>*Ibid.*, at pp. 212-13.

<sup>121</sup>See, Draft Bill, s. 9.11(1)(a).

naturally resulting in the ordinary course of events from the buyer's breach of contract.

(3) Where there is an available market for the goods in question, the measure of damages is *prima facie* to be ascertained by the difference between the contract price and the market or current price at the time or times when the goods ought to have been accepted, or, if no time was fixed for acceptance, then at the time of the refusal to accept.

52. Nothing in this Act affects the right of the buyer or the seller to recover interest or special damages in a case where by law interest or special damages may be recoverable, or to recover money paid where the consideration for the payment of it has failed.

Section 48(1) enunciates the seller's right to claim damages for non-acceptance of the goods by the buyer. Section 48(2) reproduces the so-called first rule in *Hadley v. Baxendale*,<sup>122</sup> and section 48(3) adopts the market price test as the *prima facie* measure of damages. These familiar provisions have their counterparts in section 49 of the Act, which deals with the buyer's entitlement to damages for the seller's neglect or refusal to deliver. Section 52 applies to claims by buyers and sellers, and preserves their right to recover "special damages", where they are recoverable by law. Commentators generally agree<sup>123</sup> that this section probably embodies the aggrieved party's right to claim consequential damages under the so-called second rule in *Hadley v. Baxendale*.

The damage provisions in *The Sale of Goods Act*, and the important policy questions raised by these provisions, are examined in detail in subsequent chapters.<sup>124</sup> It is not necessary to discuss here what appears in these chapters. Suffice it to say that we reaffirm the soundness of the compensatory basis for the assessment of damages adopted by *The Sale of Goods Act*. This basis is consistent with general contract law. Some changes in wording are, however, recommended for the sake of greater clarity, and to reflect post-1893 jurisprudential developments. We also examine,<sup>125</sup> in connection with our discussion of issues common to seller's and buyer's remedies, some of the difficulties associated with the concept of an "available market", and recommend, *inter alia*, the adoption of a new test of commercially reasonable disposition or purchase in place of the market price test.

At this stage of our Report, we turn to consider the extent to which the Code's provisions on the seller's damage remedies contain suggestive ideas for improvements in the existing Ontario Act. With the exception of UCC 2-706, our conclusion is that the Code's treatment, while linguistically different, is not superior in substance. In fact, in some respects the

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<sup>122</sup>(1854), 9 Exch. 341.

<sup>123</sup>For example, *Benjamin's Sale of Goods* (1974), para. 1208.

<sup>124</sup>*Infra*, ch. 17, sec. D, and ch. 18, sec. 2.

<sup>125</sup>*Infra*, ch. 18, sec. 2.

Code's draftsmen appear, unwittingly, to have created new problems. The Code's principal damage provisions involving sellers appear in UCC 2-706, 2-708, 2-710 and 1-106. The resale provisions in UCC 2-706 and their strengths and weaknesses have been discussed earlier in this chapter. The important provisions in UCC 2-708 are discussed presently. UCC 2-710 defines the meaning of incidental damages for the purposes of UCC 2-706 and UCC 2-708, and this provision has its counterpart in UCC 2-715 with respect to damage claims by the buyer. There are no exactly corresponding provisions in the Ontario Sale of Goods Act, but the right to recover incidental damages is recognized at common law, and is probably included under either section 48(2) or section 52 of that Act.<sup>126</sup> Finally, UCC 1-106 is important because of its bearing on the seller's right to recover consequential damages. This question will also be examined presently.

UCC 2-708(1) contains the Code's unremarkable market price rule.<sup>127</sup> This subsection provides as follows:

2-708.(1) Subject to subsection (2) and to the provisions of this Article with respect to proof of market price (Section 2-723), the measure of damages for non-acceptance or repudiation by the buyer is the difference between the market price at the time and place for tender and the unpaid contract price together with any incidental damages provided in this Article (Section 2-710), but less expenses saved in consequence of the buyer's breach.

It is doubtful whether UCC 2-708(1) represents an improvement on the provisions in section 48(3) of *The Sale of Goods Act*. In one respect, the Code's formulation is even less satisfactory, since it adopts the time and place of tender as the criterion for determining the market price. The rigidity of this test has attracted unfavourable comment<sup>128</sup> and is examined further in a later chapter.<sup>129</sup>

UCC 2-708(2) is new and represents the draftsmen's attempt to catch, *inter alia*, the type of damage claim presented by a "lost volume" seller where the market price rule does not provide adequate compensation. A typical example of a "lost volume" claim may arise where a purchaser reneges on an order for the purchase of a standard product from a merchant. The goods are resold by the merchant at the contract price, thus ostensibly leaving him without a loss. Nevertheless, the seller argues that he has lost the profit on the order since, but for the buyer's repudiation, he would have made an additional sale. Subsection (2) of UCC 2-708 reads as follows:

2-708.(2) If the measure of damages provided in subsection (1) is inadequate to put the seller in as good a position as performance would have done then the measure of damages is the profit (includ-

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<sup>126</sup>Compare, *Benjamin's Sale of Goods* (1974), paras. 1215, 1241. Compare also, Draft Bill, s. 9.19. We have not thought it necessary to define "incidental damages" for the purposes of s. 9.19.

<sup>127</sup>See, White & Summers, footnote 37 *supra*, at pp. 220 *et seq.*

<sup>128</sup>*Ibid.*, p. 222.

<sup>129</sup>*Infra*, ch. 18, sec. 2.

ing reasonable overhead) which the seller would have made from full performance by the buyer, together with any incidental damages provided in this Article (Section 2-710), due allowance for costs reasonably incurred and due credit for payments or proceeds of resale.

It will be noted that the language of the subsection goes well beyond the lost volume case. For this and other reasons, it has been criticized by American scholars.<sup>130</sup> Three criticisms deserve particular mention. The first is that a literal reading of the opening words would nullify the market price test in subsection (1), since only exceptionally will that test put the seller "in as good a position as performance would have done". Presumably, this is not what the draftsmen intended. Secondly, it is not clear whether subsection (2) applies where the market price rule is *too favourable* to the seller as, for example, where the buyer can show that the seller's costs to produce the goods would have exceeded the contract price. The internal and historical evidence indicates<sup>131</sup> that the draftsmen did not have this situation in mind. If this is correct, it may be argued that UCC 2-708(2) is seriously incomplete. The third criticism is that the requirement imposed by the subsection, that the seller must give "due credit" for payments or proceeds of resale, could deprive a seller of the lost profit that the subsection expressly purports to give him.<sup>132</sup> We regard the third criticism as the most serious;<sup>133</sup> the first criticism strikes us as too refined and as involving a repudiation of the market price test. The second criticism, if it is a criticism, raises a broad question of principle, which we discuss below.

The inappropriateness of the market price test where the seller has lost a sale has been recognized in a number of Commonwealth cases.<sup>134</sup> We think it should also be recognized in the revised Act by the adoption of a modified version of UCC 2-708(2). Accordingly, we recommend that,

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<sup>130</sup>White & Summers, footnote 37 *supra*, at pp. 225 *et seq.*; Harris, "A Radical Restatement of the Law of Seller's Damages: Sales Act and Commercial Code Results Compared" (1965), 18 Stan. L. Rev. 66; Peters, footnote 87 *supra*, at pp. 258-70. For other analyses of the subsection, see, Speidel and Clay, "Seller's Recovery of Overhead under UCC section 2-708(2): Economic Cost Theory and Contract Remedial Policy" (1972), 57 Corn. L. Rev. 681; Childres and Burgess, "Seller's Remedies: The Primacy of UCC 2-708(2)" (1973), 48 N.Y.U.L. Rev. 833; and Comments, (1973), 24 Case W. Res. L. Rev. 684 *et seq.*

<sup>131</sup>White & Summers, footnote 37 *supra*, at p. 233.

<sup>132</sup>*Ibid.*, at pp. 234-35.

<sup>133</sup>But, see *Neri v. Retail Marine Corp.* (1972), 285 N.E. 2d 311 (N.Y. Ct.App.), in which the Court did not find that it presented insuperable problems. The Court held that "with due credit for payments or proceeds of resale" refers to the sale of components as scrap value, and not to the sale of a completed article.

<sup>134</sup>For example, *Re Vic Mill Ltd.*, [1913] 1 Ch. 465 (C.A.); *Hill & Sons v. Edwin Showell & Sons Ltd.* (1918), 87 L.J.K.B. 1106 (H.L.); *W. L. Thompson Ltd. v. Robinson (Gunmakers) Ltd.*, [1955] Ch. 177, dist'd in *Lazenby Garages Ltd. v. Wright*, [1976] 1 W.L.R. 459, [1976] 2 All E.R. 770 (C.A.); *Charter v. Sullivan*, [1957] 2 K.B. 117 (C.A.); *Cameron v. Campbell & Worthington Ltd.*, [1930] S.A.S.R. 402; *Victory Motors Ltd. v. Bayda*, [1973] 3 W.W.R. 747 (Sask. Dist. Ct.); *Benjamin's Sale of Goods* (1974), para. 1234.

subject to our further recommendations in chapters 17 and 18, *infra*, the revised Act should contain a provision that explicitly recognizes the inapplicability of the market price test as the measure of the seller's damages for non-acceptance by the buyer where the measure of damages would be inadequate to put the seller in as good a position as performance by the buyer would have done.<sup>135</sup>

We have touched earlier on one aspect of the problem of overcompensation in recommending, in the context of UCC 2-706, that the seller should not be entitled to invoke the test that we later recommend in lieu of the market price test where he has actually resold the goods for a price higher than market, but that he should be bound by the results of the resale.<sup>136</sup> This recommendation is consistent with the reasoning of the Privy Council in *Wertheim v. Chicoutimi Pulp Co.*,<sup>137</sup> which involved a claim for damages by a buyer. The question whether a defaulting buyer should be able to resist a market price claim, or a similar claim for damages, by the seller on the ground that the seller's costs of production would have exceeded the contract price appears to be unsettled.<sup>138</sup> If the compensatory basis of contract damages is taken to its logical conclusion, the buyer's defence should succeed unless the market price test is regarded as establishing a minimum, liquidated form of measure of damages. The reasoning in *Wertheim* implicitly rejects such a characterization, as does our Draft Bill.<sup>139</sup>

Before leaving the Code's damage provisions, another significant feature of these provisions deserves to be noted. There is no reference to the seller's entitlement to recover consequential damages.<sup>140</sup> The Comments offer no reasons for this omission;<sup>141</sup> nor is it clear whether the draftsmen intended to preclude the recovery of such forms of damages.<sup>142</sup> Consequential damages are expressly allowed in a claim by the buyer,<sup>143</sup> and the

<sup>135</sup>See, Draft Bill, s. 9.10(4)(b).

<sup>136</sup>See, *supra*, this chapter, sec. 2(b)(iii).

<sup>137</sup>[1911] A.C. 301 (P.C.). See, also, *infra*, ch. 17.

<sup>138</sup>See, *Corbin on Contracts*, Vol. 5, secs. 992, 1033; Ogus, *The Law of Damages* (1973), at pp. 351-52; and compare, the important decision of Berger, J., in *Bowlay Logging Limited v. Domtar Limited*, [1978] 4 W.W.R. 105 (B.C. S.C.), and Baer, Comment, (1979), 3 C.B.L.J. 198. In American law, the problem is complicated by the plaintiff's right to elect to sue in restitution rather than for damages for breach of contract. See, Palmer, "The Contract Price as a Limitation on Restitution for Defendant's Breach" (1959), 20 Ohio State L.J. 264.

<sup>139</sup>See, Draft Bill, ss. 9.10(4)(a) and 9.16(4). One of the Commissioners, the Honourable J. C. McRuer, would prefer a clear statement in the revised Act that the seller should not recover more than his actual damages.

<sup>140</sup>Compare, NYLRC Study, ch. 5, footnote 52, *supra*, at pp. (694)-(695).

<sup>141</sup>Admittedly, consequential damage claims by sellers do not arise as often as in the case of buyer's claims, but this does not mean that they cannot occur. A good example of when they can arise is where a seller is persuaded to erect a new plant in partial reliance on a buyer's requirements contract. In such a case, breach by the buyer may leave the seller with a plant that is no longer economical to operate.

<sup>142</sup>Consequential damages were recoverable under pre-Code law: *Williston on Sales* (Rev. ed., 1948), sec. 589c, and *Uniform Sales Act*, s. 64(3).

<sup>143</sup>UCC 2-715(2).

omission of a comparable provision in the seller's case could be construed as implying the negative.<sup>144</sup> This construction gains some support from UCC 1-106, which provides, *inter alia*, that neither consequential or special nor penal damages may be had, except as specifically provided in the Act or "by other rule of law". Presumably, it could be argued that the right to recover consequential damages is covered by "other rule of law"; but this reasoning would give rise to new difficulties which need not be pursued here. Suffice it to say that the revised Act should explicitly recognize the seller's right to include in a claim for damages a claim for incidental or consequential damages, and we so recommend.<sup>145</sup>

### (c) PENALTY CLAUSES AND FORFEITURE OF MONIES PAID

Penalty clauses are not common in agreements for the sale of goods. However, they frequently occur in some types of near-sales transactions, such as hire-purchase agreements and equipment leases, and in agreements with a sale component, such as construction contracts. Forfeiture clauses, on the other hand, are a familiar phenomenon in those types of sale agreement that require the payment of a deposit or of an instalment of the price at the time the agreement is made or prior to delivery of the goods. In view of the close conceptual and practical relationship between penalty and forfeiture clauses, it seems convenient to deal with them together. At the same time, it should be emphasized that the problems raised by the existing doctrines are not peculiar to sales law, and one of the questions that needs to be considered is whether the revised Act is the appropriate place for the introduction of any desirable changes, or whether the reforms should be incorporated in a Law of Contract Amendment Act.

#### (i) *Penalty Clauses*

A clause in a contract may require the payment of a sum of money upon breach by one of the contracting parties. In a discussion of penalty clauses, it is necessary to determine whether a clause requiring payment of such a sum represents a genuine pre-estimate of damages, or whether it constitutes a non-recoverable penalty. Lord Dunedin's judgment in *Dunlop Pneumatic Tyre Co. v. New Garage & Motor Co.*<sup>146</sup> is generally accepted as accurately stating the criteria by which the courts will make this determination. In its *Working Paper on Penalty Clauses and Forfeiture of*

<sup>144</sup>Compare, *Petroleo Brasileiro, S.A. v. Ameropan Oil Corp.* (1974), 14 U.C.C. Rep. 661 (U.S.D.C., E.D.N.Y.), with *Z. D. Howard Co. v. Cartwright* (1975), 17 U.C.C. Rep. 123 (Okla. Sup. Ct.).

<sup>145</sup>See, Draft Bill, s. 9.19(1), which is intended to replace s. 52 of the present Act. This provision expressly applies to consequential and incidental damage claims by sellers and buyers. Since the new section merely continues the existing law, it does not resolve the recently re-opened question whether damages are recoverable for the failure to pay an agreed sum at the due date. The older rule was that only nominal damages were recoverable, but dicta in *Trans Trust S.P.R.L. v. Danubian Trading Co.*, [1952] 2 Q.B. 297 (C.A.), at pp. 306, 307 suggest that the rule may not be rigidly followed in the future. See, *Benjamin's Sale of Goods* (1974), para. 1195; Ogus, footnote 138 *supra*, at pp. 305-06.

<sup>146</sup>[1915] A.C. 79 (H.L.), 86-88.

*Monies Paid*,<sup>147</sup> the English Law Commission expressed the view that the existing penalty doctrine was essentially sound, but that it was deficient, or required review, in the following respects.<sup>148</sup> First, the doctrine only applies where there has been a breach; it does not apply where the contractually stipulated sum, though unconscionable, is payable on the happening of some other event, for example, upon the voluntary termination of the agreement, or where the penalty is disguised as a primary obligation that is intended to secure the same end as a penalty payable on breach.<sup>149</sup> Secondly, there is the question<sup>150</sup> whether a valid liquidated damages clause should be able to provide not only for those losses that are foreseeable at the time of the formation of the contract, but also for the recovery of other losses actually suffered by the aggrieved party, but not otherwise recoverable at law in the absence of the clause. Thirdly, it is not clear under the existing law whether the court can take into consideration the damages that may be payable by the aggrieved party to a third party; for example, by a head contractor to his employer.<sup>151</sup> Finally, the Law Commission was of the view<sup>152</sup> that the circumstances in which the courts should be entitled to award damages *higher* than those pre-estimated in the contract needed to be reconsidered.

It will be obvious that none of these points is peculiar to sales law. The question therefore arises whether the revised Act should concern itself with the penalty doctrine at all. An affirmative precedent is supplied by UCC 2-718(1), which provides as follows:

2-718.(1) Damages for breach by either party may be liquidated in the agreement but only at an amount which is reasonable in the light of the anticipated or actual harm caused by the breach, the difficulties of proof of loss, and the inconvenience or nonfeasibility of otherwise obtaining an adequate remedy. A term fixing unreasonably large liquidated damages is void as a penalty.

With one important exception, this provision appears to capture accurately the scope of the existing Anglo-Canadian doctrine,<sup>153</sup> but it does not dispose of the defects criticized by the English Law Commission. The exception involves the court's entitlement to take into consideration the actual harm caused by the breach. Leaving aside the desirability of this change, which was actually opposed by the Commission,<sup>154</sup> there appears to be little merit in merely reproducing the existing doctrine in the revised Act without, at the same time, dealing with its defects. We do not therefore

<sup>147</sup>Law Commission Working Paper No. 61, *Penalty Clauses and Forfeiture of Monies Paid* (1975).

<sup>148</sup>*Ibid.*, "Summary of Proposals", pp. 51 *et seq.*

<sup>149</sup>*Ibid.*, paras. 17 *et seq.*

<sup>150</sup>*Ibid.*, paras. 42-44.

<sup>151</sup>*Ibid.*, para. 45.

<sup>152</sup>*Ibid.*, paras. 46-48.

<sup>153</sup>For the pre-Code position in American law, see, NYLRC Study, ch. 5, footnote 52, *supra*, at pp. (703)-(706).

<sup>154</sup>Law Com. W.P. No. 61, para. 30. The Law Commission's reason was that "to judge the validity of a penalty clause by reference to circumstances as they exist after the breach would mean the introduction of an unacceptable amount of uncertainty".

recommend that the revised Act adopt a provision similar to UCC 2-718(1) dealing with penalty clauses.

(ii) *Forfeiture of Monies Paid*

The existing rules relating to forfeiture of monies paid would appear to be as follows.<sup>155</sup> First, monies paid as an earnest or as security to guarantee performance of the buyer's obligations are not recoverable on termination because of the buyer's breach, whether or not the contract contains a retention clause.<sup>156</sup> If, however, the seller seeks to recover damages, the payment will have to be brought into account.<sup>157</sup> Secondly, if the deposit constitutes part payment of the price it will be recoverable at common law by the party in breach, unless the contract provides otherwise.<sup>158</sup> If the payment is recoverable, it is subject to any right of set-off that the seller may have in respect of damages he has suffered.<sup>159</sup> Thirdly, even where there is a retention clause, equity has jurisdiction to grant relief from forfeiture of the monies paid,<sup>160</sup> although the extent of this jurisdiction and the circumstances in which the court will exercise its discretion are both uncertain.<sup>161</sup>

The Law Commission's Working Paper criticized<sup>162</sup> the illogical distinction drawn by the existing law between penalty clauses and the doctrine of forfeiture, and argued persuasively that in both cases the courts should be empowered to prevent overreaching. The Working Paper considered a number of alternative proposals for the improvement of the existing law.<sup>163</sup> The proposal most favoured by the Law Commission<sup>164</sup> was that the fairness of a forfeiture clause should be tested by the same criteria as are applied to determine the enforceability of penalty clauses; that is, whether the amount of the deposit represents a "genuine pre-estimate" of the loss likely to be occasioned by a breach of the contract.<sup>165</sup> The Law Commission opposed the adoption of a general test of unconscionability in this context as likely to lead to too much uncertainty. The Law Commission recognized that the adoption of its preferred test would lead to the invalidation of most types of existing retention clauses.

UCC 2-718(2) embodies what appears to be a reasonable compromise of the conflicting policy considerations. This subsection provides as follows:

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<sup>155</sup>*Benjamin's Sale of Goods* (1974), paras. 1161-63 (forfeiture of deposits), and 1203-04 (forfeiture clauses in instalment payment contracts); Law Com. W.P. No. 61, paras. 50-56.

<sup>156</sup>*Howe v. Smith* (1884), 27 Ch. D. 89 (C.A.).

<sup>157</sup>Benjamin, footnote 155 *supra*, paras. 1161-62.

<sup>158</sup>*Dies v. British & International Mining and Finance Corp. Ltd.*, [1939] 1 K.B. 724.

<sup>159</sup>*Ibid.*

<sup>160</sup>*Stockloser v. Johnson*, [1954] 1 Q.B. 476 (C.A.).

<sup>161</sup>Law Com. W.P. No. 61, paras. 54-55.

<sup>162</sup>*Ibid.*, paras. 57 *et seq.*

<sup>163</sup>*Ibid.*, paras. 61 *et seq.*

<sup>164</sup>*Ibid.*, para. 65.

<sup>165</sup>The Law Commission recognized, however, that a special rule might be desirable with respect to deposits on the sale of land: Law Com. W.P. No. 61, paras. 65-67.

2-718.(2) Where the seller justifiably withholds delivery of goods because of the buyer's breach, the buyer is entitled to restitution of any amount by which the sum of his payments exceeds

- (a) the amount to which the seller is entitled by virtue of terms liquidating the seller's damages in accordance with subsection (1), or
- (b) in the absence of such terms, twenty per cent of the value of the total performance for which the buyer is obligated under the contract or \$500, whichever is smaller.

It will be observed that paragraph (a) substantially coincides with the Law Commission's suggested test, although it is not clear whether the statutory provision will apply in the absence of a liquidated damages clause, or whether a simple retention clause will suffice. The advantages of the minimum retention sum authorized by paragraph (b) are twofold: it recognizes that a breach of contract usually involves the innocent party in some damages, however difficult they may be to quantify; and, it avoids vexatious arguments where small amounts are involved by imposing a readily applied, albeit admittedly arbitrary, formula.

We recognize that a stronger case can be made for the insertion in the revised Act of a provision similar to UCC 2-718(2) than can be made for a provision similar to UCC 2-718(1) dealing with penalty clauses. Nevertheless, we do not recommend that the revised Act adopt a provision similar to UCC 2-718(2). The relationship between penalty and forfeiture clauses is so close that it seems best to treat them together in any revision of the law. We therefore recommend that the whole topic be remitted for further study to the Law of Contract Amendment Project.

#### 4. LESSOR'S REMEDIES FOR BREACH OF LEASE AGREEMENT

The close relationship between various types of modern leasing agreements and contracts of sale, and the difficulties encountered under the existing law, have been discussed in earlier chapters.<sup>166</sup> We there recommended that certain of the implied warranties in *The Sale of Goods Act* should be formally extended to lease agreements of all types.<sup>167</sup> We further recommended that the question whether, and to what extent, statutory changes should be made to clarify the quantum of damages recoverable by a lessor in a true chattel lease for breach of the agreement by the lessee, should be referred to the Advisory Committee on The Personal Property Security Act.

It remains to consider whether additional changes are desirable in order to assimilate the remedies of a lessor with those of a seller. It will be noted that, even if the default provisions in Part V of *The Personal Property Security Act* were extended to a wide range of lease agreements, these provisions would only regulate the remedies of the lessor where the goods have been delivered to the lessee and the lessee has defaulted. *The*

<sup>166</sup>*Supra*, ch. 4, sec. 3(f), ch. 9, sec. 5.

<sup>167</sup>Compare, Draft Bill, s. 5.15.

*Personal Property Security Act* does not prescribe the lessor's remedies where the lessee repudiates before delivery of the goods. These remedies are, therefore, governed by common law principles. As a result, a lessor would still not have the statutory rights of lien, stoppage *in transitu*, and of resale that are conferred on a seller. However, there appears to be no pressing need for a formal assimilation of these rules of law and, in any event, the circumstances are not identical. In a lease agreement, the question of lien rights would only arise to the extent that payments are due on or before delivery. If payments are so due, the lessor will normally have a contractual right to withhold delivery. The right of stoppage has already lost most of its practical importance in the sales area, and it is difficult to conceive of a situation in which it would confer much benefit on a lessor. The unpaid seller's statutory right of resale, as has been noted earlier, is not exhaustive of the seller's rights of resale. Further, on general contract principles the lessor would seem to have rights of cancellation similar to those of a seller, where the lessee has repudiated the agreement.<sup>168</sup> The same observations would appear to apply with respect to the lessor's personal remedies. For obvious reasons, the market price test does not apply,<sup>169</sup> but the courts do not appear to have experienced much difficulty in assessing damages on general foreseeability principles,<sup>170</sup> once the hurdles of penalty clauses and the proper characterization of the lessee's breach have been overcome.

The upshot of these cursory remarks is simply to emphasize that the appropriateness of applying all the sales rules in a leasing context should not be taken for granted, and that further study of the problem is needed. What has been said above with respect to the lessor's remedies applies, *mutatis mutandis*, to the lessee's remedies. It may be that a general analogical rule such as has been previously recommended<sup>171</sup> will be found sufficient, at any rate in the absence of a separate code of lessor's and lessee's remedies.

Accordingly, we recommend that the revised Act should not apply the seller's real and personal remedies to the remedies of a lessor for breach of contract by a lessee, and that, until further study of the question is undertaken, the revised Act should contain no specific provisions dealing with a lessor's remedies for breach by a lessee.

### RECOMMENDATIONS

The Commission makes the following recommendations:

1. The revised Act should contain an index section of the seller's real and personal remedies. This section should,
  - (a) refer explicitly to the seller's right to cancel; and

<sup>168</sup>Compare, *Bridge v. Campbell Discount Co. Ltd.*, [1962] A.C. 600 (H.L.).

<sup>169</sup>Although there appears to be no reason why it cannot be applied by analogy where there is a ready market for leased goods of the same type.

<sup>170</sup>See, for example, *Interoffice Telephones Ltd. v. Robert Freeman Co. Ltd.*, [1958] 1 Q.B. 190 (C.A.); *Robophone Facilities Ltd. v. Blank*, [1966] 1 W.L.R. 1428, [1966] 3 All E.R. 128 (C.A.).

<sup>171</sup>*Supra*, ch. 4, sec. 6.

- (b) distinguish between the remedies for substantial and for non-substantial breaches of a contract of sale.
2. (a) In the case of the buyer's late payment or failure to take delivery the seller should be allowed to treat the breach as a substantial breach, whether or not it would otherwise be a substantial breach, where the buyer has failed to cure his default after being given reasonable notice by the seller to do so.
    - (b) The seller should have this right upon the buyer's failure to take delivery, notwithstanding that the buyer may have paid for the goods in full or in part.
  3. The seller's right to demand cure should not be extended to all breaches by the buyer, but should be restricted to cases where the buyer fails to make payment or to take delivery of the goods. There should, however, be an enlarged construction in the revised Act of the meaning of payment and taking delivery, so as to include such preparatory steps (for example, the opening of a letter of credit or the designation of a vessel or other carrier) as may reasonably be considered part of the buyer's obligations to make payment and to take delivery.
  4. With respect to the seller's real remedies, the revised Act should draw no distinction between those cases in which title has passed to the buyer, and those in which it has not.
  5. Following the Code nomenclature, the seller's lien right should be described in the revised Act as a right to withhold.
  6. The seller's right to withhold under the revised Act should incorporate the following features.
    - (a) The seller should be able to withhold delivery of goods in his possession in the following circumstances:
      - (i) until the buyer pays any sum due on or before delivery;
      - (ii) until payment of the price where the buyer is insolvent; or
      - (iii) where the buyer repudiates the contract, until retraction of the repudiation as provided in other provisions of the revised Act;
    - (b) It should be made clear that, where the seller has extended credit, he cannot justify withholding the goods on the ground of non-payment where he has not met his delivery obligations;
    - (c) The right to withhold should be affirmed even though the seller is in possession of the goods as agent or bailee for the buyer;
    - (d) The right to withhold where there has been part delivery should cover amounts due under an instalment contract as

well as amounts due under an entire or indivisible contract. However, this right should not be enlarged further so as to confer a lien in respect of future payments as well as over-due payments;

- (e) It should be made clear that a judgment for the price does not affect the seller's right to withhold delivery;
  - (f) The right to withhold delivery should include any reasonable expenses in relation to the care and custody, transportation and stoppage of the goods, and other incidental expenses incurred by the seller subsequent to the buyer's breach or insolvency.
7. The revised Act should not confer upon the seller a general statutory non-possessory lien right; nor should it confer a limited statutory non-possessory lien right in a case where the buyer has become insolvent after receiving the goods. These recommendations are not, however, intended to derogate from the seller's right to obtain a consensual security interest in accordance with the provisions of *The Personal Property Security Act*.
  8. The seller's right of stoppage *in transitu* should be retained in the revised Act, subject to the following amendments.
    - (a) The right of stoppage should be extended to all cases where the goods are in the possession of a carrier or other bailee, whether or not for the purpose of transmission to the buyer;
    - (b) The right of stoppage should be exercisable not only where the buyer is insolvent but also where the buyer has repudiated, fails to make a payment due before delivery, or if for any other reason the seller has a right to withhold or reclaim the goods;
    - (c) Unlike the position under UCC 2-705, the right of stoppage should not be limited to larger shipments of freight, whether or not the buyer is insolvent;
    - (d) The extended right of stoppage should apply to all types of bailee; and
    - (e) It should be made clear that a judgment for the price does not affect the right of stoppage.
  9. A provision comparable to UCC 2-706 dealing with the seller's right of resale should be adopted in the revised Act, subject to the following clarifications or amendments.
    - (a) The right of resale should be available to a seller only where the buyer's conduct amounts to a substantial breach;
    - (b) Where a seller has exercised his right of resale, he should be bound by the results of the resale in claiming his damages. The recommended general provision in the revised Act dealing with the computation and measure of the seller's damages

should state that the seller is not entitled to sue for the difference between the contract price and the price recommended in chapter 18, *infra*, for adoption in lieu of the market price, if his actual loss is less than this difference;

- (c) The resale requirements should be simplified, and the seller should be deprived of his right to sue for damages under this provision only when he "does not resell in a commercially reasonable manner";
  - \* (d) The seller should not be required to give notice of his intention to resell.
- \*\*10. Where the seller exercises his right of resale or otherwise cancels the contract, the buyer should not be entitled to cure his breach and to thereby reinstate the contract.
11. A seller who has exercised his right of resale should not be accountable to the buyer for any surplus.
12. The revised Act should not contain a provision requiring the seller to exhaust his real remedies before being entitled to sue for the price.
13. With respect to a seller's action for the price,
- (a) the revised Ontario Act should adopt a provision similar to UCC 2-709 in place of section 47 of the existing Ontario Sale of Goods Act; and
  - (b) the provision in the revised Act comparable to UCC 2-709 should make it clear that the seller may recover the price due where goods have been accepted, unless the buyer has justifiably revoked his acceptance.
14. Subject to further recommendations in chapters 17 and 18, *infra*, the revised Act should expressly recognize:
- (a) the inapplicability of the market price test as the measure of the seller's damages for non-acceptance by the buyer where the measure of damages would be inadequate to put the seller in as good a position as performance by the buyer would have done; and
  - (b) the seller's right to include in a claim for damages, a claim for incidental or consequential damages.
15. The revised Act should not adopt a provision similar to UCC 2-718(1) dealing with penalty clauses, nor a provision similar to UCC 2-718(2) dealing with forfeiture clauses. These topics should be remitted for further study to the Law of Contract Amendment Project.

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\*The Honourable J. C. McRuer and Mr. William R. Poole dissent from this recommendation. See, footnote 98, *supra*.

\*\*The Honourable Richard A. Bell dissents from this recommendation. See, footnote 95, *supra*.

16. The revised Act should not apply the seller's real and personal remedies to the remedies of a lessor for breach of contract by a lessee, and, until further study of the question is undertaken, the revised Act should contain no specific provisions dealing with a lessor's remedies for breach by a lessee.



### BUYER'S REMEDIES

#### A. INDEX OF BUYER'S REMEDIES AND CHARACTERIZATION OF SELLER'S BREACHES

Under existing law, an aggrieved buyer has a variety of remedies, not all of which are spelled out in the Ontario Sale of Goods Act. The nature of these remedies will vary with the nature of the breach and the time it comes to light, the type of goods and the nature of the damages. If the seller, prior to the delivery date, notifies the buyer that he will not meet his delivery obligation, the buyer is confronted with an anticipatory breach which, at his election, he may ignore or accept. If the buyer accepts the repudiation, the agreement, subject to the buyer's right to sue for damages, is deemed at an end. Where there is no anticipatory repudiation but the seller fails to deliver at the proper time, the buyer is usually limited to an action in damages for non-delivery. Exceptionally, however, he may be entitled to an order for specific performance or to other forms of specific relief. If goods are tendered but are non-conforming in character, the buyer usually has an option. If the non-conformity involves breach of a condition and the contract does not involve a sale of specific goods the property in which has passed to the buyer, the buyer may reject and, once again, sue for damages for non-delivery or content himself with a restitutionary claim for the return of any payments he may have made. If he elects to retain the goods he does not waive his claim to damages. This will be equally true if the non-conformity does not come to light until after the buyer is deemed to have accepted the goods; Anglo-Canadian law does not recognize a general right to rescind on account of a latent defect, except where the seller has been guilty of fraud or, possibly, innocent misrepresentation. Where the buyer is entitled to sue for damages for breach of the contract of sale, his damages will be assessed on the same basis of compensation for loss as in claims by the seller in the reverse situation, and subject to the rules of foreseeability enunciated in *Hadley v. Baxendale*. The buyer may also be entitled to sue in tort if the defective goods have caused personal injury or damage to other property.

From the foregoing it will be seen that the buyer has a rich and generally powerful range of remedies. Nevertheless, they suffer from various difficulties, some of which have already been alluded to in earlier chapters. These difficulties are the focus of the present chapter.<sup>1</sup> For the moment it seems appropriate to conclude these introductory remarks with a preliminary comparison between the buyer's remedies under Anglo-Canadian law and those conferred by Article 2. UCC 2-711, in an index

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<sup>1</sup>But not exclusively so. Several issues common to seller's and buyer's remedies are discussed in chapter 18. In addition, this chapter is only concerned with a buyer's remedies against a seller from whom he has purchased the goods. With respect to his remedies against the manufacturer or other person in the distributive chain with whom he is not in privity, see, *supra*, ch. 10.

section comparable to UCC 2-703,<sup>2</sup> lists the buyer's remedies, non-exhaustively, as follows:

2-711.(1) Where the seller fails to make delivery or repudiates or the buyer rightfully rejects or justifiably revokes acceptance then with respect to any goods involved, and with respect to the whole if the breach goes to the whole contract (Section 2-612), the buyer may cancel and whether or not he has done so may in addition to recovering so much of the price as has been paid

- (a) "cover" and have damages under the next section as to all the goods affected whether or not they have been identified to the contract; or
- (b) recover damages for non-delivery as provided in this Article (Section 2-713).

(2) Where the seller fails to deliver or repudiates the buyer may also

- (a) if the goods have been identified recover them as provided in this Article (Section 2-502); or
- (b) in a proper case obtain specific performance or replevy the goods as provided in this Article (Section 2-716).

(3) On rightful rejection or justifiable revocation of acceptance a buyer has a security interest in goods in his possession or control for any payments made on their price and any expenses reasonably incurred in their inspection, receipt, transportation, care and custody and may hold such goods and resell them in like manner as an aggrieved seller (Section 2-706).

The above provisions are, as we have stated, non-exhaustive. They must be read in conjunction with the provisions in Parts 5 and 6 of Article 2 on cure, rejection, revocation of acceptance, adequate assurance of performance, anticipatory repudiation and instalment contracts. The Code's remedial approach looks a little unfamiliar at first, but closer examination reveals that the essential framework is not a great deal different from Anglo-Canadian law. The important differences between the Code remedies and those existing under Ontario law are the following. Where the buyer has reasonable grounds for concern that the seller may not be able to perform, he may, just like the seller in the reverse situation, request "adequate assurance of performance" from the seller and may, if commercially reasonable, suspend performance of his own obligations in the meantime.<sup>3</sup> The consequences of acts of anticipatory repudiation are spelled out specifically<sup>4</sup> in the Code and differ significantly from those obtaining under Ontario law. The buyer's right to reject non-conforming goods<sup>5</sup> is, in the Code, subject to the seller's circumscribed entitlement to offer

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<sup>2</sup>This section lists the seller's remedies. See, *supra*, ch. 16, sec. 1.

<sup>3</sup>See, UCC 2-609 and, further, *infra*, ch. 18, sec. 3.

<sup>4</sup>UCC 2-610, 2-611. See, further, *infra*, ch. 18, sec. 4.

<sup>5</sup>UCC 2-601.

“cure”.<sup>6</sup> On the other hand, the buyer may “revoke” his acceptance<sup>7</sup> (a concept previously enshrined in the *Uniform Sales Act*, but under a different label<sup>8</sup>) if the non-conformity could not reasonably have been discovered before acceptance or if discovery has been delayed because of the seller’s assurances. If the buyer rejects, he is given<sup>9</sup> a statutory security interest to the extent of any part of the purchase price he has paid. Offsetting this gain is his obligation<sup>10</sup> to take reasonable care of the goods and to follow reasonable instructions of the seller with respect to the disposition of the goods. Corresponding to the remedy of an aggrieved seller,<sup>11</sup> the buyer may by-pass the uncertainties of the market price test and “cover” his loss by making a substitutional purchase.<sup>12</sup> The remedy of specific performance is still a matter for the court’s discretion,<sup>13</sup> but it has been liberalized in an important respect.<sup>14</sup> Finally, but not least importantly, the buyer’s right to reject non-conforming goods or to cancel the contract for other breaches does not *prima facie* turn either on the gravity of the breach or on the classification of the obligation breached; the seller is generally subject to a “perfect tender” rule. However, as will be seen, there are many exceptions to this rule.

We have previously recommended<sup>15</sup> that the revised Act should eschew *a priori* characterization of obligations, whether they be obligations of the seller or buyer, and that, instead, remedies should turn on the gravity of the breach and whether or not it is substantial in character. Although the distinction between the perfect tender rule and our substantial breach test is of conceptual importance, the practical differences between these two tests will often be small, given the Code’s many exceptions to the perfect tender rule. However this may be, we think that our new remedial regime should be clearly spelled out. Accordingly, we recommend that the revised Act should contain an index section of buyer’s remedies. This section should distinguish between the remedies for substantial and non-substantial breach of a contract of sale.<sup>16</sup>

It will be convenient, at this stage, to set out our recommended index section of buyer’s remedies. Our recommended draft provision reads as follows:<sup>17</sup>

- 9.12.(1) Where the seller breaches the contract, the buyer may,
- (a) maintain an action for damages;
  - (b) seek specific performance,
- as provided in this Act.

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<sup>6</sup>UCC 2-508.

<sup>7</sup>UCC 2-608.

<sup>8</sup>S. 69(1)(d), (3), (4) and (5).

<sup>9</sup>UCC 2-711(3).

<sup>10</sup>UCC 2-603(1).

<sup>11</sup>UCC 2-706.

<sup>12</sup>UCC 2-712.

<sup>13</sup>UCC 2-716.

<sup>14</sup>It is not confined to the sale of specific goods. See, *infra*, pp. 440-41.

<sup>15</sup>*Supra*, ch. 6, sec. B.

<sup>16</sup>See, Draft Bill, s. 9.12.

<sup>17</sup>*Ibid.*

(2) Where the seller's conduct amounts to a substantial breach and the seller repudiates, fails to make delivery or to perform an act due before delivery, or where the buyer rightfully rejects or revokes acceptance, the buyer, in addition to his rights under subsection 1 and subject to section 7.7, may exercise any one or more of the following rights:

1. Cover and recover damages as provided in this Act.
2. Cancel the contract.
3. Recover so much of the price as has been paid.

We appreciate that a test of substantiality of breach, in the case of breach by the seller, may introduce some uncertainty. It seems desirable that any uncertainties that may so arise should be reduced as far as possible. Two different situations must be considered. The first involves the seller's failure to tender the goods (or, in a documentary shipment, the documents of title) by the agreed date. Here, following our earlier recommendation with respect to untimely performance by the buyer,<sup>18</sup> we would allow the buyer to treat the seller's default as a substantial breach after reasonable notice has been given to the seller, even though the initial breach did not amount to a substantial breach. Comparable provisions, it may be noted, exist in ULIS<sup>19</sup> and in the draft UNCITRAL Convention.<sup>20</sup> The second situation involves a tender that is conforming as to time, but non-conforming in some other respect. The buyer's right to demand cure in such a case, even though the non-conformity is only minor in character, raises a much more difficult issue and is intimately linked with the seller's right to cure where the buyer has rightfully rejected the goods. It will be convenient to postpone discussion of both questions to a later section of this chapter.<sup>21</sup>

The organization of the balance of this chapter is as follows. We begin with the remedy of specific performance. We then discuss the buyer's rights of rejection of non-conforming goods and, ancillary thereto, the questions of cure, acceptance, and revocation of acceptance. We then turn to discuss the damages remedy. Discussion of restitutionary remedies forms the subject matter of the final part of this chapter. As in the case of the seller's remedies, we deal in a separate chapter, chapter 18, with a number of remedial issues that are common to both parties.

## B. SPECIFIC PERFORMANCE AND OTHER FORMS OF SPECIFIC RELIEF

### 1. SECTION 50 OF THE SALE OF GOODS ACT

Different legal systems approach the remedy of specific performance in different ways.<sup>22</sup> In some jurisdictions the remedy is regarded as a pri-

<sup>18</sup>*Supra*, ch. 16, sec. 1.

<sup>19</sup>Art. 44(2).

<sup>20</sup>Art. 29(1).

<sup>21</sup>*Infra*, this. ch., sec. C.1(d)(ii).

<sup>22</sup>Treitel, "Remedies for Breach of Contracts" in *International Encyclopedia of Comparative Law*, Vol. VII, ch. 16, at pp. 6 *et seq.*; Dawson, "Specific Performance in France and Germany" (1959), 57 Mich. L. Rev. 495.

mary remedy, but subject to various types of exceptions; in other jurisdictions it is regarded as an exceptional remedy and available only at the discretion of the court. The common law jurisdictions belong to this latter group. Some lawyer-economists have begun to question the economic efficiency of the restrictive common law attitude,<sup>23</sup> but this raises fundamental issues going well beyond the sales field and we do not pursue them. Suffice it to say that we continue to support the discretionary character of the remedy.

Section 50 of the Ontario Sale of Goods Act<sup>24</sup> contains the existing provisions controlling the buyer's entitlement to specific performance. This section has an interesting history. It substantially reproduces section 2 of the U.K. *Mercantile Law Amendment Act, 1856*,<sup>25</sup> which in turn was inspired by a Report of the Mercantile Law Commissioners.<sup>26</sup> The Commissioners favoured aligning the then English law with the more generous rules of Scottish law. It is arguable that section 2 and its successor did not fully reflect the Commissioners' recommendations; but this is water under the bridge. This is because, since *In re Wait*<sup>27</sup> it has generally been accepted that section 50 is now the sole source of the buyer's right to an order for specific performance.

As we have stated, we support the discretionary character of the remedy of specific performance. Nevertheless, we are of the opinion that section 50 of the Ontario Act raises difficulties of substance that merit careful consideration. Section 50 provides:

50. In an action for breach of contract to deliver specific or ascertained goods, the court may, if it thinks fit, direct that the contract be performed specifically, without giving the defendant the option of retaining the goods on payment of damages, and may impose such terms and conditions as to damages, payment of the price, and otherwise, as to the court seems just.

We now consider three difficulties arising from this section: namely, its restriction to "specific or ascertained goods"; the relationship between the section and the buyer's right to obtain an order for replevin under *The Replevin Act*,<sup>28</sup> and, the lack of mutuality of the remedy of specific performance as between the buyer and the seller.

<sup>23</sup>See, for example, Kronman, "Specific Performance" (1978), 45 U. Chi. L. Rev. 351. Compare, Posner, *Economic Analysis of Law* (2nd ed., 1977), pp. 95-97.

<sup>24</sup>The corresponding provision in the U.K. *Sale of Goods Act, 1893*, is section 52.

<sup>25</sup>19 & 20 Vict., c. 97 (U.K.). The section was prolix and provided, *inter alia*, that in an action for breach of contract to deliver specific goods for a price in money the court, at its discretion, "shall have power to order execution to issue for the delivery . . . of the said goods, without giving the defendant the option of retaining the same upon paying the damages assessed;"

<sup>26</sup>*Second Report of the Commissioners appointed to Inquire and Ascertain how far the Mercantile Laws in the different parts of the United Kingdom of Great Britain and Ireland may be Advantageously Assimilated* (1855), p. A2. See, further, Treitel, "Specific Performance in the Sale of Goods", [1966] J.B.L. 211.

<sup>27</sup>[1927] 1 Ch. 606 (C.A.); but see, *contra*, Treitel, footnote 26 *supra*, pp. 222 *et seq.*; and, compare, *Sky Petroleum Ltd. v. V.I.P. Petroleum Ltd.*, [1974] 1 W.L.R. 576, [1974] 1 All E.R. 954.

<sup>28</sup>R.S.O. 1970, c. 412.

The first difficulty arising from the section is the fact that the court's power is restricted to contracts involving the sale of "specific or ascertained goods". The term "specific goods" is defined in section 1(1)(m) of the Ontario Act to mean goods "identified and agreed upon at the time the contract of sale is made". It is unsettled<sup>29</sup> whether, for the purposes of section 50, future goods may be regarded as specific goods, at any rate where nothing further needs to be done once the goods come into existence or into the possession of the seller. The Act contains no definition of the term "ascertained goods". In *Thames Sack and Bag Co. Lim. v. Knowles & Co. Lim.*,<sup>30</sup> Sankey, J., held that "ascertained" means that "the individuality of the goods must in some way be found out, and when it is, then the goods have been ascertained". In *In re Wait*<sup>31</sup> Atkin, L.J., defined the expression more succinctly as probably meaning "identified in accordance with the agreement after the time a contract of sale is made". Whichever of these definitions is correct, each is subject to a limitation of far-reaching practical importance. As is well known, in *In re Wait* the English Court of Appeal held that there can be no ascertainment of part of a larger bulk of goods until the part has been actually earmarked and segregated from the bulk.

The difficulties that flow from the restrictive wording of section 50 are illustrated by the recent English decision of *Sky Petroleum Ltd. v. V.I.P. Petroleum Ltd.*<sup>32</sup> In this case, the plaintiff, the buyer, sought an interim injunction to restrain the defendant, the seller, from breaching its obligation under a long term contract to supply the plaintiff with its requirements of gasoline and diesel fuel. Because of the Arab oil embargo and the related events of 1973, there was little prospect of the plaintiff's being able to procure alternative supplies from another source. The Court granted the application. Goulding, J., reasoned that there was a serious danger that, unless interim relief was granted, the plaintiff company would be forced out of business before the case could be tried on its merits. Goulding, J., granted the order even though he acknowledged the general rule that specific performance will not be granted in respect of a contract for the purchase of chattels that are not specific or ascertained, and that the interim injunction was tantamount to making an order for specific enforcement of the contract for the time being. The Court did not attempt to reconcile its decision with that in *In re Wait*.

An important — perhaps the most important — category of contracts, those that involve neither specific nor ascertained goods, is, therefore, excluded from the reach of section 50. The question arises whether the section is exhaustive of the buyer's rights. Can the buyer fall back on his general equitable remedies, on the assumption that relief in equity is not confined to specific or ascertained goods? In a frequently cited passage, Atkin, L.J., in *In re Wait*<sup>33</sup> expressed the firm view that section 50

<sup>29</sup>See, Treitel, footnote 26 *supra*, at pp. 218-19.

<sup>30</sup>(1919), 88 L.J.K.B. 585, at p. 588.

<sup>31</sup>*Supra*, footnote 27, at p. 630.

<sup>32</sup>[1974] 1 W.L.R. 576, [1974] 1 All E.R. 954.

<sup>33</sup>[1927] 1 Ch. 606 (C.A.), at p. 635.

codifies the buyer's rights, and, as we have stated,<sup>34</sup> this is the view that has been generally followed in subsequent decisions. Atkin, L.J., offered no explanation why Parliament should have wished to reduce the ambit of the remedy of specific performance, and the history of the section does not support the thesis. Whatever the merits of the dispute, it seems desirable that the uncertainty should be resolved in the revised Act by deleting the confining words "specific or ascertained goods". As will be seen, this is also the Code's solution.

The second difficulty arising from section 50 involves the relationship between that section and the buyer's right to obtain a replevin order under the Ontario Replevin Act.<sup>35</sup> Section 50, as has been noted, only confers a discretionary remedy, and it is well settled that an order for specific performance will not be granted where damages are an adequate substitute. For this purpose it matters not that title to the goods has passed to the buyer,<sup>36</sup> and it is equally well established that the buyer cannot improve his position by suing in detinue.<sup>37</sup> So it may be said that in this respect equity and the common law operate in tandem.

However, the Ontario Replevin Act appears to contain an exception of some importance to this rule. At common law, an action in replevin only lay where the person suing for replevin alleged a wrongful seizure of his goods.<sup>38</sup> The restitutionary remedy could not be invoked where the seller merely refused to deliver goods that had been in his lawful possession all the time. In this respect, *The Replevin Act* appears to have made an important change in the law. Section 2 of the Act permits the owner or other person capable of maintaining an action for damages to bring a replevin action for the recovery of goods "wrongfully . . . detained", as well as for those wrongfully distrained or otherwise wrongfully taken. Assuming that title has passed to the buyer, it would appear that he is entitled to compel delivery by a recalcitrant seller by following the prescribed procedure, and it has been so held on a number of occasions.<sup>39</sup>

The reason for the extension in Ontario of the common law remedy of replevin is obscure,<sup>40</sup> and it is not clear whether the draftsman appreciated a potential conflict with the rules of specific performance and the action in detinue. Presumably, the extension reflects the judgment of the legislature that, where the person suing for replevin claims superior pro-

<sup>34</sup>*Supra*, this ch., at p. 437.

<sup>35</sup>R.S.O. 1970, c. 412.

<sup>36</sup>*Cohen v. Roche*, [1927] 1 K.B. 169.

<sup>37</sup>*Ibid.*; and see, also, *Whiteley Ltd. v. Hilt*, [1918] 2 K.B. 808 (C.A.). The same result would obtain in equity if the owner were to seek an order for specific restitution: Fleming, *The Law of Tort* (5th ed., 1977), at pp. 71-73.

<sup>38</sup>*Mennie v. Blake* (1856), 119 E.R. 1078, 6 E. & B. 842; Holmsted & Gale, *The Judicature Act of Ontario and Rules of Practice*, Vol. II, pp. 1662-63 (1977 Suppl.).

<sup>39</sup>For example, *O'Rourke v. Lee* (1859), 18 U.C.Q.B. 609; *Lee v. Ianson* (1910), 1 O.W.N. 586; and compare, *Van Hull v. Mancor*, [1944] 1 W.W.R. 114 (Man. C.A.).

<sup>40</sup>The present Replevin Act traces its ancestry to an Act of 1851, 14 & 15 Vict., c. 64, which was entitled "An Act to amend and extend the Law relating to the remedy of Replevin in Upper Canada". See, Holmsted & Gale, footnote 38 *supra*. Vol. II, p. 1663 (1977 Suppl.).

prietary or possessory rights, the person resisting the order for replevin should not be given the option of paying damages. However this may be, it appears anomalous that a buyer to whom title has passed should be able to obtain relief in a replevin action, and yet not be able to obtain an order for specific performance under *The Sale of Goods Act*. *The Replevin Act* does not, however, fall within our terms of reference and we refrain from offering any recommendations for its amendment beyond drawing attention to this conflict.

The third difficulty arising out of section 50 involves the principle of mutuality. *The Sale of Goods Act* confers no reciprocal rights of specific performance in favour of the seller, and it is not clear to what extent he can invoke equitable principles to rectify the statutory omission. We share the view<sup>41</sup> that the doctrine of mutuality has no particular merit, at any rate in relation to chattels, and that the seller's entitlement to specific performance should stand on its own feet and not be coloured by the question whether specific relief would have been available at the suit of the buyer. This is the approach adopted in the Code and the approach that also appeals to us.

## 2. THE UNIFORM COMMERCIAL CODE PROVISIONS

Section 68 of the *Uniform Sales Act* was in substantially the same terms as section 52 of the U.K. Act, the forerunner of section 50 of the Ontario Act, although the American courts tended to interpret the words "specific or ascertained goods" less restrictively than the English courts.<sup>42</sup> In addition, section 66 of the *Uniform Sales Act* reserved to the buyer, when the property in the goods had passed to him and the seller had neglected or refused to deliver them, the right to maintain any action allowed by law to the owner of goods of similar kind when wrongfully converted or withheld. Both these provisions of the *Uniform Sales Act* have been re-enacted in section 2-716 of the *Uniform Commercial Code*, albeit in a substantially modified form. In addition, Article 2 contains a new section, section 2-502, which deals explicitly with the right of a buyer to recover goods from an insolvent seller. Each of these provisions must be considered separately.

We first turn to section 2-716. This section provides as follows:

2-716.(1) Specific performance may be decreed where the goods are unique or in other proper circumstances.

(2) The decree for specific performance may include such terms and conditions as to payment of the price, damages, or other relief as the court may deem just.

(3) The buyer has a right of replevin for goods identified to the contract if after reasonable effort he is unable to effect cover for such goods or the circumstances reasonably indicate that such effort will be unavailing or if the goods have been shipped under reserva-

<sup>41</sup>This is the view of Professor Treitel, footnote 26 *supra*, at p. 229.

<sup>42</sup>*Williston on Sales* (Rev. ed., 1948), p. 327, n. 11.

tion and satisfaction of the security interest in them has been made or tendered.

The first two subsections deal with the buyer's right to obtain a decree of specific performance. The significant change made here is that the confining words in section 68 of the *Uniform Sales Act*, "specific or ascertained goods", have been abandoned in favour of the double-barrelled test of the uniqueness of the goods *or* the existence of "other proper circumstances". At first sight the reference to uniqueness conveys an 18th century antiquarian flavour; but Comment 2 to UCC 2-716(1) makes it plain that this was not the draftsmen's intention. This Comment states that the test of uniqueness under section 2-716 must be made, "in terms of the total situation which characterizes the contract". The Comment continues:

Output and requirements contracts involving a particular or peculiarly available source or market present today the typical commercial specific performance situation, as contrasted with contracts for the sale of heirlooms or priceless works of art which were usually involved in the older cases. However, uniqueness is not the sole basis of the remedy under this section for the relief may also be granted 'in other proper circumstances' and inability to cover is strong evidence of 'other proper circumstances'.

It is clear, therefore, that the draftsmen's intention was to extend the buyer's remedy to a full range of goods, both present and future, and whether specific or not. Apart from these points, there does not appear to be any difference in substance between the policy of the Code and the policy of section 50 of the Ontario Sale of Goods Act.

Section 2-716(3) marks an important departure from prior American state law. Under prior American law, a buyer to whom title in the goods had passed was entitled to initiate replevin proceedings to recover the goods *in specie*. As noted, this is the position that apparently obtains under the existing Ontario Replevin Act.<sup>43</sup> Under the Code provision, the right of recovery is restricted to those cases where the buyer is unable to effect cover or it is clear that any effort to do so would be futile, or to those cases where the seller has only retained a security interest in goods that have been shipped. The rationale for these restrictions is given in Comment 4, which states that the section "is intended to give the buyer rights to the goods comparable to the seller's rights to the price". In a more expanded form, what this means is that the draftsmen thought that the buyer's right to recover the goods should be no greater than the seller's right to sue for the price under UCC 2-709. We have no quarrel with subsection (3) and we consider that it reflects a reasonable policy. However, subsection (3) has no counterpart in the Ontario Sale of Goods Act, and we have previously indicated that we deem replevin remedies to be outside our terms of reference. We, therefore, content ourselves with drawing attention to this feature of the Code.

The other provision of Article 2 that we here consider is section

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<sup>43</sup>*Supra*, at p. 439.

2-502. As we have noted, this section deals explicitly with the right of a buyer to recover goods from an insolvent seller. UCC 2-716, like section 50 of the Ontario Act, provides no preferential treatment for the buyer who has paid all or part of the price for goods identified to the contract, but not delivered to him before the seller's insolvency. Section 2-502 confers upon the buyer a severely circumscribed priority. The section provides as follows:<sup>44</sup>

2-502.(1) Subject to subsection (2) and even though the goods have not been shipped a buyer who has paid a part or all of the price of goods in which he has a special property under the provisions of the immediately preceding section may on making and keeping good a tender of any unpaid portion of their price recover them from the seller if the seller becomes insolvent within ten days after receipt of the first installment on their price.

(2) If the identification creating his special property has been made by the buyer he acquires the right to recover the goods only if they conform to the contract for sale.

It will be seen that the important requirements are as follows: (a) the buyer must have a special property in the goods (that is, the goods must have been identified to the contract pursuant to the provisions in UCC 2-501); (b) the buyer must have paid all or part of the price; and, (c) the seller's insolvency must have occurred within ten days after receipt of the first instalment on the price. In practice the last requirement is likely to prove fatal in the great majority of cases, even if the buyer's claim were not subject to the additional hazards of the competing claims of creditors and buyers in ordinary course under UCC 2-402 and 2-403.<sup>45</sup> It will be an unwise buyer, therefore, who relies on UCC 2-502, in the event of the seller's insolvency, to protect his progress payments. His prudent course<sup>46</sup> would be either to require the seller to be bonded, or to obtain a security interest in the goods pursuant to Article 9 or, in Ontario, under *The Personal Property Security Act*. However, the Article 9 and Ontario provisions are not properly structured to cope with this type of problem.<sup>47</sup>

<sup>44</sup>For general discussions of the provisions of section 2-502, see, *inter alia*, Kennedy, "The Trustee in Bankruptcy Under the Uniform Commercial Code: Some Problems Suggested By Articles 2 and 9" (1960), 14 Rutgers L. Rev. 518, at p. 556; Speidel, "Advance Payments in Contracts for Sale of Manufactured Goods: A Look at the Uniform Commercial Code" (1964), 52 Cal. L. Rev. 281; and Gordon, "The Prepaying Buyer: Second Class Citizenship Under Uniform Commercial Code Article 2" (1968), 63 N.W.U.L. Rev. 565.

<sup>45</sup>UCC 2-501 is discussed in ch. 11, *supra*. UCC 2-402 and UCC 2-403 are discussed in ch. 12, *supra*.

<sup>46</sup>Compare, Speidel, footnote 44 *supra*.

<sup>47</sup>It must suffice to mention two difficulties that arise under *The Personal Property Security Act*, R.S.O. 1970, c. 344, as am. The first is that in the Act "purchase money security interest" (s. 1(s)) and the priority it confers do not apply to a buyer's security interest. The second is that the default provisions in Part V of the Act envisage resale of the collateral as the secured party's primary remedy, whereas the buyer presumably would prefer an absolute option to retain the goods in satisfaction of the seller's obligations.

The Canadian position is unclear. There is evidence<sup>48</sup> that our courts may be more generous in granting an order for specific performance where the seller is insolvent than where he is solvent. It may also be that, under the provisions of the *Bankruptcy Act*,<sup>49</sup> the buyer will be entitled as of right to the release of goods in the bankrupt seller's possession, if he can show that he has title to the goods and that there has been compliance with the registration requirements of any applicable Bills of Sale legislation.

The problem of the buyer's right to recover goods from an insolvent seller is no doubt an important one. We do not, however, think that the proper answer is to be found in UCC 2-502, even assuming that it would be constitutionally competent for Ontario to adopt such a provision. The prime issue seems to be one of priority in bankruptcy, and, in our view, the issue is best resolved within that context. It may also be that *The Personal Property Security Act* should be reviewed with a view to determining whether it should be amended to accommodate more adequately the security needs of buyers; but this appears to be a question that falls within the domain of the Advisory Committee on that Act.

### 3. CONCLUSIONS

In light of the foregoing discussion, we now set out our conclusions and recommendations concerning the buyer's right to specific performance and to other forms of specific relief:

- (1) Section 50 of the Ontario Sale of Goods Act is, in our view, defective. We are, however, of the opinion that its deficiencies can be cured without a total recasting of the section. Apart from the elimination of the reference to "specific or ascertained goods", we do not find UCC 2-716(1) and (2) inherently superior; in some respects, indeed, these subsections may be less flexible than section 50. We recommend<sup>50</sup> that the provision in the revised Act comparable to section 50 of the existing Ontario Act should not be confined to contracts for the delivery of "specific or ascertained goods", but should read as follows:<sup>51</sup>

In an action against the seller for breach of contract to deliver promised goods, whether or not the goods existed or were identified at the time of the contract, the court may direct that the contract be performed specifically and may impose such terms and conditions as to damages, payment of the price, and otherwise, as seem just to the court.

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<sup>48</sup>See, Duncan & Honsberger, *Bankruptcy in Canada* (3rd ed., 1961), p. 332, especially nn. 13-14.

<sup>49</sup>R.S.C. 1970, c.B-3, s.47, specifies the property of the bankrupt that is included or excluded from his estate and divisible among his creditors. A literal reading of the section leads to the conclusion that the trustee is not entitled to claim (or presumably retain) property that is not owned by the bankrupt. See, further, Duncan & Honsberger, footnote 48 *supra*, at pp. 288 *et seq.*

<sup>50</sup>The Honourable J. C. McRuer dissents from this recommendation. It is Mr. McRuer's position that a contract for the sale of non-existent or unidentified goods is not one the performance of which the court can supervise.

<sup>51</sup>Draft Bill, s. 9.18.

It will be observed that the important difference between the existing and the recommended section, is that the recommended section omits any requirement that the goods must be in existence or identified to the contract at the time of the contract. As is true of the present section, the recommended section imposes no restrictions on the court's discretion, whether by reference to "unique goods" or otherwise. This should allow ample scope for the development of the remedy of specific performance in the light of changing circumstances and new perceptions about the adequacy of damages.

- (2) No attempt should be made in the revised Sales Act to resolve an apparent conflict between the buyer's right to compel delivery of the goods under *The Replevin Act* and the discretionary remedy of specific performance under *The Sale of Goods Act*. Any change in the Ontario Replevin Act, as applicable to contracts of sale, should form part of a comprehensive review of replevin law.
- (3) We recommend that the revised Act should not contain a provision equivalent to UCC 2-502, dealing with the buyer's right to recover goods from an insolvent seller; rather, this issue should be resolved within the context of the law of bankruptcy. Consideration should also be given to a review of *The Personal Property Security Act* by the Advisory Committee on that Act, with a view to determining whether it should be amended to accommodate more adequately the security needs of buyers.

## C. REJECTION, ACCEPTANCE AND CURE

### 1. GENERAL CONSIDERATIONS

The concept of the buyer's right to reject non-conforming goods is easy to grasp. It is based on the notion that the buyer should not be obliged to accept and pay for goods that do not meet the contractual specifications. What is much more difficult to define are the circumstances in which the buyer should be entitled to exercise the right, for it is obvious that not every breach can justify this drastic remedy. The possible considerations that enter into the equation, as seen from the buyer's and seller's points of view, will be discussed hereafter. The scheme of this part of the chapter is as follows. We shall first consider the present Anglo-Canadian position and indicate some of its most important shortcomings. This will be followed by a review of the American position and the treatment of the issues in the Uniform Law on the International Sale of Goods and the 1977 draft UNCITRAL Convention. We then offer our own recommendations for change in the light of the comparative materials and the interests competing for attention.

#### (a) THE ANGLO-CANADIAN POSITION

The buyer's right to reject non-conforming goods is not spelled out clearly in any single section of the Ontario Sale of Goods Act, and the total picture can only be gleaned from a reading of a variety of sections

of this Act. The key to the buyer's right is not the gravity of the seller's breach but, rather, the characterization of the term that has been breached. The seller's conduct may involve a breach of condition; that is, breach of an essential term of the contract. In this event, if none of the limitations imposed by the Act applies, the buyer will be entitled to reject the goods. If, however, the term breached is characterized as a warranty, the buyer's remedy will only lie in damages.

As was noted in an earlier chapter,<sup>52</sup> 19th century case law adopted a dichotomous classification of the seller's major implied obligations. These implied obligations were classified into conditions and warranties, a scheme that was carried forward into *The Sale of Goods Act*. Thus, sections 13 to 16 of the Ontario Act characterize as conditions the seller's obligations with respect to title, description, merchantability, fitness and correspondence to sample. Only the implied terms of quiet possession and freedom from encumbrances are characterized as warranties.<sup>53</sup> To the enumeration of circumstances entitling the buyer to reject must be added the important provisions in section 29 concerning the effect of a delivery of goods that are defective in terms of quantity and description. The Act<sup>54</sup> does not classify the seller's obligation with respect to time of delivery but, in commercial transactions, the cases have almost invariably treated this obligation as a condition. Only with respect to instalment sales<sup>55</sup> does the Act, in section 30, abandon its usual approach; but the exception is more apparent than real, because section 30 is really concerned with the impact of a present breach on future obligations.

It will be seen, therefore, that, with minor exceptions, *The Sale of Goods Act* and the courts have adopted a rule of strict compliance with respect to performance of the seller's most important obligations. From the seller's point of view, the consequences are serious. As a long line of cases demonstrates, this rule means that the buyer may reject a tender, even though the non-conformity is minor in character, the buyer is not substantially prejudiced, and the seller is willing to cure the defect or to make an appropriate monetary allowance. If a breach of title is involved, it can be argued that this goes so much to the root of the agreement that the breach and its severity are inextricably linked together.<sup>56</sup> But the same can hardly be said of the other implied terms with their broad generic concepts, where great variations in the extent and impact of any particular breach are the rule rather than the exception.

#### (i) *Limitations on the Right to Reject*

As we have indicated, under *The Sale of Goods Act* the seller is required to comply strictly with the obligations characterized as conditions; otherwise the buyer may reject the goods. To some extent, however, the rigidities of this rule of strict compliance have been masked by a number of important exceptions. But, these exceptions have not been con-

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<sup>52</sup>*Supra*, ch. 6, sec. B.

<sup>53</sup>See, s. 13(b) and (c) of the Ontario Sale of Goods Act.

<sup>54</sup>S. 11.

<sup>55</sup>*Infra*, ch. 18, sec. 5.

<sup>56</sup>Although, even here, as will be seen, a right to cure seems appropriate.

sistently developed, and they contain some serious anomalies that need to be rectified in the revised Act. While their cumulative effect may be to provide the courts with a series of useful weapons with which to curb the excesses of this rule of strict compliance, they also have the less desirable result of preventing the rejection of goods where a substantial breach of the seller's obligations has occurred. We turn now to consider the recognized exceptions to the rule of strict compliance.

(1) *Acceptance of the Whole or Part of a Non-Severable  
Consignment and Sale of Specific Goods: s. 12(3)*

Section 12(3) of the Ontario Sale of Goods Act contains three exceptions to the rule of strict compliance. This subsection provides as follows:

12.(3) Where a contract of sale is not severable and the buyer has accepted the goods or part thereof, or where the contract is for specific goods the property in which has passed to the buyer, the breach of any condition to be fulfilled by the seller can only be treated as a breach of warranty and not as a ground for rejecting the goods and treating the contract as repudiated, unless there is a term of the contract, express or implied, to that effect.

By virtue of this provision, a buyer loses his right to reject in three circumstances: first, where a contract of sale is not severable and the buyer has accepted the goods; secondly, in the case of a non-severable contract where the buyer has accepted part of the goods, the so-called "partial acceptance" rule; and thirdly, where the contract is for "specific goods the property in which has passed to the buyer". It will be convenient to consider separately these three aspects of section 12(3).

(aa) *Acceptance of Goods in a Non-Severable  
Contract*

A very important exception to the rule of strict compliance is found in the provision of section 12(3) that, unless otherwise agreed, where a contract of sale is not severable and the buyer has accepted the goods, breach of any condition by the seller can only be treated as breach of a warranty and not as a ground for rejecting the goods. The rationale of this exception is obvious and proceeds from the premise that the buyer has agreed to retain the goods or has made an election to do so. The difficulty arises from the concept of acceptance, which we discuss below.<sup>57</sup>

(bb) *Acceptance of Part of a Non-Severable  
Consignment*

The first part of section 12(3) of the Act codifies the common law rule<sup>58</sup> that, in a non-severable contract, the buyer loses his right to reject, even if he has accepted only part of the goods. The partial acceptance rule raises two difficulties.

In the first place, the commercial reasonableness of this rule is not

<sup>57</sup>*Infra*, sec. C. 1(a)(ii).

<sup>58</sup>*Benjamin's Sale of Goods* (1974), para. 894, especially n. 73. See, also Friedman, *Sale of Goods in Canada* (1973), pp. 212-15.

obvious.<sup>59</sup> If a clothing manufacturer delivers 100 dresses to a retailer, 95 of which conform to the contract and 5 of which are non-conforming, there appears to be no adequate reason why the retailer should not be able to retain the satisfactory dresses and reject the defective ones. Presumably, this course of action would also be in the manufacturer's interest, since his losses will be that much greater if the buyer is forced to reject the whole consignment. While the *Uniform Sales Act* did not expressly reject the partial acceptance rule,<sup>60</sup> it was substantially undermined by the New York Court of Appeals in a leading case, *Portfolio v. Rubin*,<sup>61</sup> and the process has been completed in Article 2. UCC 2-601 provides, *inter alia*, that if the goods or the tender of delivery fail in any respect to conform to the contract, the buyer may (a) reject the whole, (b) accept the whole, or (c) accept any commercial unit or units and reject the rest. "Commercial unit" is defined<sup>62</sup> to mean "such a unit of goods as by commercial usage is a single whole for purposes of sale and division of which materially impairs its character or value on the market or in use". We support the Code's approach and, as will be discussed below, where the non-conformity amounts to a substantial breach, favour its adoption in the revised Ontario Act.<sup>63</sup>

The second difficulty arises from the conflict between the provisions of section 29 and section 12(3) of the Ontario Sale of Goods Act. Section 29<sup>64</sup> clearly confers upon the buyer the right to reject that part of a consignment which is non-conforming as to quantity or description. In *W. Barker (Jr.) & Co. Ltd. v. Edward T. Agius Ltd.*,<sup>65</sup> Salter, J., experienced great difficulty in trying to reconcile the two provisions, but felt that precedent obliged him to give primacy to section 29. Assuming his construction is correct,<sup>66</sup> it leads to the curious result that, if part of a consignment is unmerchantable or unfit for its intended use, the buyer

<sup>59</sup>Compare, Williston, footnote 42 *supra*, Vol. 3, sec. 493a, p. 69; Note, "Return of Part of the Goods Delivered Under A Sales Contract: Harmonizing Legal Theory and Business Practice" (1935), 35 Col. L. Rev. 726.

<sup>60</sup>Williston, footnote 42 *supra*, sec. 493b, p. 71.

<sup>61</sup>(1922), 233 N.Y. 439; 125 N.E. 843 (C.A.).

<sup>62</sup>UCC 2-105(6), first sentence. See, Draft Bill, s. 1.1(1)6.

<sup>63</sup>See, Draft Bill, s. 8.1.

<sup>64</sup>Section 29 provides as follows:

(1) Where the seller delivers to the buyer a quantity of goods less than he contracted to sell, the buyer may reject them, but if the buyer accepts the goods so delivered, he shall pay for them at the contract rate.

(2) Where the seller delivers to the buyer a quantity of goods larger than he contracted to sell, the buyer may accept the goods included in the contract and reject the rest, or he may reject the whole, and if the buyer accepts the whole of the goods so delivered, he shall pay for them at the contract rate.

(3) Where the seller delivers to the buyer the goods he contracted to sell mixed with goods of a different description not included in the contract, the buyer may accept the goods that are in accordance with the contract and reject the rest, or he may reject the whole.

(4) This section is subject to any usage of trade, special agreement or course of dealing between the parties.

<sup>65</sup>(1927), 33 Com. Cas. 120.

<sup>66</sup>The facts were unusual in that the buyer resold and delivered part of the consignment to the sub-buyer before becoming aware of the non-conformity of the balance of the consignment.

must reject the whole consignment, whereas he can reject in part and accept in part if the non-conformity goes to quantity or description.<sup>67</sup> Adoption of the Code solution would also eliminate this anomaly, as UCC 2-601 does not distinguish between different types of non-conformity. This section of the Code permits the buyer to accept or reject the whole or any part as he sees fit. The only restriction is that his acceptance or rejection must comprise one or more commercial units and be made in good faith.<sup>68</sup> If this approach is adopted in Ontario, as we recommend below, it would dispense altogether with the need for the revised Act to contain a provision equivalent to section 29 of the existing Act.

### (cc) *Sale of Specific Goods*

The second part of section 12(3) of the Ontario Sale of Goods Act lays down the astonishing rule that the buyer has no right to reject non-conforming goods in the case of a contract for the sale of specific goods the property in which has passed to the buyer. The impact of this part of section 12(3), if read literally, is much wider than the partial acceptance rule because of the frequency and commercial importance of sales of specific goods, especially in retail transactions. The denial of the right to reject in such circumstances is difficult to justify. The rule has its origins in an early decision, *Street v. Blay*,<sup>69</sup> and is apparently based on the reasoning that, once title has passed, the buyer cannot unilaterally revest it in the seller. Williston has shown<sup>70</sup> the unsoundness of this proposition and its inconsistency with other branches of contract law, where the buyer has long been permitted to rescind unilaterally; for example, because of a fraudulent misrepresentation. The doctrine in *Street v. Blay* was, apparently, never adopted in American law.

This second part of section 12(3) is not often invoked in practice in Canada,<sup>71</sup> and it has been largely undermined by the controversial decision of the English Divisional Court in *Varley v. Whipp*.<sup>72</sup> Nevertheless, there is every reason why this anomalous restriction on the right to reject should be removed from *The Sale of Goods Act*. In adopting this step, Ontario would merely be following the example set in section 4(1) of the U.K. *Misrepresentation Act 1967*.<sup>73</sup>

<sup>67</sup>See, *Benjamin's Sale of Goods* (1974), para. 862, p. 385: "It is difficult to justify the application of one policy for quantity and another for quality."

<sup>68</sup>The good faith requirement is not expressly imposed in UCC 2-601 but is referred to in Official Comment 1. Under our earlier recommendations, *supra*, ch. 7, sec. B. 4, good faith in the exercise of rights and remedies would always be implied.

<sup>69</sup>(1831) 2 B. & Ad. 456, [1824-34] All E.R. 329 (K.B.).

<sup>70</sup>Williston, "Rescission for Breach of Warranty" (1903), 16 Harv. L. Rev. 465, and *Williston on Sales* (Rev. ed., 1948), Vol. 3, secs. 608-8a.

<sup>71</sup>But, see, *Home Gas Ltd. v. Streeter*, [1953] 2 D.L.R. 842 (Sask. C.A.), where it was successfully invoked.

<sup>72</sup>[1900] 1 Q.B. 513, followed in *J. I. Case Threshing Co. v. Fee* (1909), 10 W.L.R. 70 (Sask.); and see, further, Fridman, footnote 58 *supra*, pp. 74-76; Atiyah, *The Sale of Goods* (5th ed., 1975), pp. 146-47.

<sup>73</sup>1967, c. 7 (U.K.).

## (2) *The De Minimis Rule*

This rule, that the law will ignore trifling breaches, is not expressly stated in *The Sale of Goods Act*, but it enshrines a principle common to many legal systems. In the sales context, the difficulty is to know when the courts will invoke it and what will be deemed to be a deviation of microscopic proportions — a deviation not worthy of the law's notice. A deviation of less than one percent in the quantity of goods delivered of the right description might be thought to satisfy the test, but it has not always been so held.<sup>74</sup> Again, in *I.B.M. v. Shcherban*<sup>75</sup> a broken glass dial in a computing scale costing \$294, which could have been replaced for 25 or 30 cents, was held sufficiently significant to make the goods unmerchantable and, therefore, to entitle the buyer to reject. Even if the courts could be encouraged to find a larger role for the *de minimis* rule, its practical value as a meaningful restraint on the right to reject would remain marginal.

## (3) *Some Miscellaneous Restrictions on the Right to Reject*

An important restriction on the buyer's right to reject is imposed by section 30 of the Ontario Sale of Goods Act, which deals with instalment sales. The provisions of section 30 are considered more fully in a later chapter.<sup>76</sup> All that we wish to note at this stage is that, in a technical sense, section 30 is concerned, not with the buyer's right to reject a non-conforming instalment, but, rather, with the impact of an admitted breach on the seller's willingness and ability to fulfil the unperformed part of his obligation. Even admitting this, the fact remains that the Act has abandoned the mechanistic approach adopted with respect to entire and indivisible contracts, and instead allows the individual facts to determine the consequences of the initial breach on the balance of the seller's obligations.

Room for flexibility is also present in the concepts of merchantability and fitness for purpose.<sup>77</sup> The first concept is predicated on the reactions of a reasonable buyer and his expectations; the second concept aims not towards perfect fitness, but only towards reasonable fitness. Both concepts, therefore, allow generous scope for innovative handling of borderline cases in which there is non-conformity but the non-conformity is not of a sufficiently serious nature to justify rejection. Regrettably, until recently, Anglo-Canadian courts have shown little inclination to seize this opportunity.<sup>78</sup> In particular, our courts have failed to develop, as perhaps they could have developed, a concept of the seller's right to cure an imperfect tender where this would be compatible with the buyer's expectations of merchantability and reasonable fitness. Our courts have not developed such a concept other than in the case where the time for delivery has not

<sup>74</sup>*Wilensko v. Fenwick & Co. (West Hartlepool) Ltd.* (1938), 54 T.L.R. 1019, [1938] 3 All E.R. 429 (K.B.).

<sup>75</sup>[1925] 1 W.W.R. 405 (Sask. C.A.).

<sup>76</sup>*Infra*, ch. 18, sec. 5.

<sup>77</sup>*Supra*, ch. 9, sec. 3.

<sup>78</sup>Lord Denning's judgment in *Cehave N.V. v. Bremer Handelsgesellschaft m.b.H.*, [1976] 1 Q.B. 44 (C.A.), at p. 55 suggests new winds of change may be in the offing.

expired. In such a case, the seller has been given a right to cure.<sup>79</sup> It needs to be stressed, however, that mitigating the rigours of the rule of strict compliance by such means would not involve, and should not be construed as involving, the denial of relief for even minor defects.

(ii) *Acceptance of the Goods*

As we have stated, by virtue of section 12(3) of *The Sale of Goods Act*, where the contract of sale is not severable and the buyer has accepted the goods his right of rejection, unless otherwise agreed, is lost. In this context, reference must be made to sections 33 and 34 of the Ontario Sale of Goods Act. These sections contain important provisions concerning, respectively, the buyer's right to examine goods when they are tendered or delivered to him, and the buyer's deemed acceptance of goods. These sections provide as follows:

33.(1) Where goods are delivered to the buyer that he has not previously examined, he shall be deemed not to have accepted them until he has had a reasonable opportunity of examining them for the purpose of ascertaining whether they are in conformity with the contract.

(2) Unless otherwise agreed, when the seller tenders delivery of goods to the buyer, he shall, on request, afford the buyer a reasonable opportunity of examining the goods for the purpose of ascertaining whether they are in conformity with the contract.

34. The buyer shall be deemed to have accepted the goods when he intimates to the seller that he has accepted them, or when the goods have been delivered to him and he does any act in relation to them that is inconsistent with the ownership of the seller, or when, after the lapse of a reasonable time, he retains the goods without intimating to the seller that he has rejected them.

These provisions and, in particular, their Code counterparts, will be examined more closely in a later part of this chapter.<sup>80</sup> For the moment, it will suffice to draw attention to several constructional and conceptual difficulties whose collective effect is, once again, to impose severe restrictions on the buyer's right of rejection.

The first difficulty is that, as judicially construed,<sup>81</sup> (and unless otherwise agreed) the buyer's right of examination, contained in section 33, is *prima facie* confined to the time and place of delivery of the goods. A literal application of this rule would, in many situations, deprive the buyer of a meaningful right of examination. The second difficulty is that, according to section 34, the buyer is deemed to have accepted the goods when, after delivery, "he does any act in relation to them that is inconsistent with the ownership of the seller". Since many post-delivery acts

<sup>79</sup>*Borrowman, Phillips, & Co. v. Free & Hollis* (1878), 4 Q.B.D. 500 (C.A.); *Scythes & Co. v. Dods Knitting Co.* (1922), 52 O.L.R. 475 (App. Div.).

<sup>80</sup>*Infra*, pp. 467 *et seq.*

<sup>81</sup>*Perkins v. Bell*, [1893] 1 Q.B. 193 (C.A.); *Benjamin's Sale of Goods* (1974), para. 874. Supporting Canadian authorities are collected in Fridman, footnote 58 *supra*, p. 265, n. 82.

committed by a buyer could be construed as inconsistent with the seller's title (assuming he still has title, which is another source of difficulty) it will be appreciated that a strict application of this test could substantially undermine the buyer's right to reject non-conforming goods. The leading decision of the English Court of Appeal in *Hardy & Co. v. Hillerns & Fowler*<sup>82</sup> went a considerable distance towards doing just that, at least where the goods were resold and trans-shipped by the buyer subsequent to their delivery. Subsequent courts have been hard put to distinguish the decision.<sup>83</sup> The Court of Appeal accentuated the difficulties by holding that the reasonable time to examine, seemingly assured in section 33(1) of the Act, does not take priority over the deemed acceptance provisions in section 34.<sup>84</sup>

Finally, section 34 also provides that the buyer is deemed to have accepted the goods when, "after the lapse of a reasonable time, he retains the goods without intimating to the seller that he has rejected them". This test must be read in conjunction with the buyer's entitlement under section 33 to "a reasonable opportunity" of examining the goods to determine their conformity. As a result, the buyer's right to reject is severely circumscribed in time, even though the defect is latent and cannot be ascertained by ordinary examination or testing and does not manifest itself until a considerable time has elapsed after delivery. We pause to note that Anglo-Canadian law has no remedy corresponding to the redhibitory action in Roman law for latent defects,<sup>85</sup> the right to rescind for breach of warranty in the *Uniform Sales Act*,<sup>86</sup> or the right to revoke an acceptance recognized in Article 2.

#### (b) THE AMERICAN POSITION

The treatment of the right to reject<sup>87</sup> in the *Uniform Sales Act* shared important similarities with the U.K. *Sale of Goods Act*, but differed from it in other important respects. Nineteenth century American common law followed the English rule of strict compliance, and this rule was reproduced by Williston in section 69 of the *Uniform Sales Act*. Indeed, the Uniform Act went considerably further than the English approach, since the Act did not distinguish between warranties and conditions, but apparently impressed all the seller's contractual obligations with the same

<sup>82</sup>[1923] 2 K.B. 490 (C.A.).

<sup>83</sup>See, for example, *Kwei Tek Chao v. British Traders and Shippers Ltd.*, [1954] 2 Q.B. 459; *Hammer & Barrow v. Coca-Cola*, [1962] N.Z.L.R. 723 (S.C.); *A. J. Frank & Sons Ltd. v. Northern Peat Co.*, [1963] 2 O.R. 415, (1963), 39 D.L.R. (2d) 721 (C.A.).

<sup>84</sup>This aspect of the decision has now been reversed in the U.K. by s. 4(2) of the *Misrepresentation Act 1967*, c. 7.

<sup>85</sup>The remedy is recognized in the Quebec Civil Code, arts. 1522 *et seq.*; and see, Durnford "The Redhibitory Action and the 'Reasonable Diligence' of Article 1530 C.C." (1963), 9 McGill L.J., 16.

<sup>86</sup>S.69(1)(d); see, *Williston on Sales* (Rev. ed., 1948), secs. 608 *et seq.*

<sup>87</sup>See, generally, Honnold, "Buyer's Right of Rejection" (1949), 97 U. Pa. L.Rev. 457; Whaley, "Tender, Acceptance, Rejection and Revocation — the UCC's 'Tarr'-Baby" (1974-75), 24 Drake L.Rev. 52; Priest, "Breach and Remedy for the Tender of Nonconforming Goods under the Uniform Commercial Code: An Economic Approach" (1978), 91 Harv. L. Rev. 960; White & Summers, *Handbook of the Law Under the Uniform Commercial Code* (1972), ch. 8.

quality. The Uniform Act<sup>88</sup> also adopted the English concept of acceptance and its impact upon the buyer's right to reject non-conforming goods. In the case of latent defects, however, the Uniform Act avoided the difficulties under the U.K. Act by permitting the buyer to rescind the sale even after he was deemed to have accepted the goods.<sup>89</sup> The price the buyer was forced to pay for this extended privilege was the abandonment of any claim to damages, because rescission was deemed to put an end to the contract for all purposes. So far as the right to reject was concerned, the Uniform Act also drew no distinction between a sale of specific goods and the sale of other goods.

The concept of a single classification of contractual obligations has been retained in Article 2. So also, on a first reading, has the rule of strict compliance, generally referred to in American literature as the "perfect tender" rule. Section 2-601 provides:

2-601. Subject to the provisions of this Article on breach in installment contracts (Section 2-612) and unless otherwise agreed under the sections on contractual limitations of remedy (Sections 2-718 and 2-719), if the goods or the tender of delivery fail in any respect to conform to the contract, the buyer may

- (a) reject the whole; or
- (b) accept the whole; or
- (c) accept any commercial unit or units and reject the rest.

The initial impression is misleading because there are at least seven direct and indirect exceptions to the perfect tender rule, as appears from the following list:

(a) *Direct Exceptions*

- 1. Revocation of acceptance.<sup>90</sup>
- 2. Instalment contracts.<sup>91</sup>
- 3. Right to cure an imperfect tender.<sup>92</sup>
- 4. Duty to act in good faith.<sup>93</sup>
- 5. Non-materiality of failure to notify of shipment.<sup>94</sup>

(b) *Indirect Exceptions*

- 6. Ready implication of acceptance.<sup>95</sup>
- 7. Waiver of buyer's objections through failure to particularize.<sup>96</sup>

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<sup>88</sup>S.48.

<sup>89</sup>Ss. 69(1)(d), 69(3); Williston, footnote 86 *supra*, secs. 608 *et seq.*

<sup>90</sup>See, UCC 2-608 and *infra*, sec. C.2.

<sup>91</sup>See, UCC 2-612 and *infra*, ch. 18, sec. 5.

<sup>92</sup>See, UCC 2-508 and *infra*, sec. C.1(d)(ii).

<sup>93</sup>See, UCC 1-203, 2-103(1)(b) and *supra*, ch. 7, sec. B.

<sup>94</sup>See, UCC 2-504 and *supra*, ch. 14, sec. A.3(b).

<sup>95</sup>See, UCC 2-606 and *infra*, p. 470.

<sup>96</sup>See, UCC 2-605 and *infra*, pp. 478-79.

The cumulative effect of these exceptions and restrictions is to draw much of the sting from the perfect tender rule.<sup>97</sup> The American courts have shown themselves particularly resourceful in using the Code's fairly complex acceptance and revocation of acceptance provisions to deny the right to reject. But whether the perfect tender rule has been deprived of all practical effect is a matter for conjecture. There may still be circumstances in which the buyer will be entitled to reject for even minor non-conformities, particularly where the right to cure does not apply or the seller cannot cure or is not willing to do so.

We turn now to discuss the seller's right to cure an imperfect tender under the Code. Before so doing, we would mention that the Code's exceptions to the perfect tender rule appear to be motivated by a variety of reasons.<sup>98</sup> Section 2-608(2) provides that revocation of acceptance must occur within a reasonable time after, *inter alia*, the buyer discovers or should have discovered the ground for revocation. The reason for this exception appears to be the greater prejudice to the seller, where the buyer seeks to reject after a substantial period has elapsed, than the prejudice to the seller where the buyer exercises his remedy promptly after delivery. In the case of instalment sales, by UCC 2-612, delivery by the seller of a non-conforming instalment does not necessarily confer upon the buyer a right to cancel the whole contract. The continuing relationship between the parties imposed by the contract appears to make the difference, although the soundness of the distinction may be questioned. Prejudice to the seller, on the other hand, underlies the penalty for failure to particularize under UCC 2-605, and the same reasoning seems to support the Code provisions dealing with lack of good faith. The exception in UCC 2-504 appears to be based on a lack of prejudice to the buyer.

The right to cure is based on the seller's reasonable expectations, as well as on a presumed lack of prejudice to the buyer. The right plays such an arresting role in the Code's treatment of the seller's performance obligations and the buyer's right to reject, that it deserves closer examination.<sup>99</sup> UCC 2-508 provides:

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<sup>97</sup>"We conclude, and the cases decided to date suggest, that the foregoing changes have so eroded the perfect tender rule that little is left of it; the law would be little changed if 2-601 gave the right to reject only upon 'substantial' nonconformity": White & Summers, footnote 87 *supra*, p. 257. It appears that Karl Llewellyn, the principal architect of Article 2, also favoured the adoption of a substantial performance rule, at least in dealings between merchants, and his earlier drafts of what later became Article 2 reflected this philosophy. However, his views did not meet with general acceptance, which, in the light of subsequent judicial developments, seems ironic. See, further, Priest, footnote 87 *supra*, at pp. 968-71.

<sup>98</sup>Honnold, footnote 87 *supra*, at pp. 472 *et seq.*

<sup>99</sup>For more detailed discussions, see Honnold, footnote 87 *supra*, at pp. 473 *et seq.*; Peters, "Remedies For Breach of Contracts Relating to the Sale of Goods Under the Uniform Commercial Code: A Roadmap for Article Two" (1963), 73 Yale L.J., 199, at pp. 210 *et seq.*; Hawkland, "Curing an Improper Tender of Title to Chattels: Past, Present and Commercial Code" (1962), 46 Minn. L. Rev. 697; Priest, footnote 87 *supra*; Comment, "Uniform Commercial Code — Sales — Sections 2-508 and 2-608 — Limitations on the Perfect-Tender Rule" (1970), 69 Mich. L. Rev. 130.

2-508.(1) Where any tender or delivery by the seller is rejected because non-conforming and the time for performance has not yet expired, the seller may seasonably notify the buyer of his intention to cure and may then within the contract time make a conforming delivery.

(2) Where the buyer rejects a non-conforming tender which the seller had reasonable grounds to believe would be acceptable with or without money allowance the seller may if he seasonably notifies the buyer have a further reasonable time to substitute a conforming tender.

The important distinction between the two subsections may be stated in this way: by subsection (1), a seller who tenders non-conforming goods or documents of title before the time for performance has expired has an absolute right to cure;<sup>100</sup> the right of the seller to cure under subsection (2) is, on the other hand, restricted to cases in which he had reasonable grounds to believe that his non-conforming tender would be acceptable, with or without a money allowance. What then are "reasonable grounds" for his belief? Comment 2 to UCC 2-508 explains that such reasonable grounds can lie "in prior course of dealing, course of performance or usage of trade as well as in the particular circumstances surrounding the making of the contract". The Comment continues with the following caveat:

The seller is charged with commercial knowledge of any factors in a particular sales situation which require him to comply strictly with his obligations under the contract as, for example, strict conformity of documents in an overseas shipment or the sale of precision parts or chemicals for use in manufacture. Further, if the buyer gives notice either implicitly, as by a prior course of dealing involving rigorous inspections, or expressly, as by the deliberate inclusion of a 'no replacement' clause in the contract, the seller is to be held to rigid compliance.

It would therefore seem clear that the section does not give *carte blanche* to the seller to offer to cure in order to resist any and all efforts by the buyer to reject the goods, and that the seller's actual or imputed knowledge of the buyer's requirements and expectations may militate as much against the right to cure as in its favour.

The Code's guidelines may work well in commercial transactions where both parties are professionals and familiar with the usages of the trade. However, they offer much less assistance in the large range of consumer transactions, and generally in those sales where the goods are intended for use and not for resale. The construction of UCC 2-508(2) gives rise to other difficulties, of which the following are some of the more important:

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<sup>100</sup>This conforms with the pre-Code rule and Anglo-Canadian law. See, footnote 79 *supra*, and *infra*, sec. C.1(d)(ii)(1).

- (a) Subsection (2) only applies where the seller reasonably believed that his non-conforming tender would be acceptable "with or without money allowance". It is not clear whether these words preclude other forms of adjustment or correction;
- (b) The concluding words of subsection (2) suggest that the seller must make a new and conforming tender. Does this mean that the seller must tender a new and different item or can the conforming tender comprise the goods originally tendered but now put into a conforming condition?<sup>101</sup> A related question is whether a money allowance, or an offer to let the buyer repair the goods at the seller's expense, is sufficient. The reference to an allowance in the earlier part of the subsection would support such an inference, but the concluding words are opposed thereto;
- (c) Does the right to cure apply to any type of defect, however serious in nature? The reported cases have mostly involved minor defects, but commentators are not agreed whether the right to cure should be so confined;<sup>102</sup>
- (d) It is not clear whether UCC 2-508(2) applies to documentary tenders. UCC 2-612(2) distinguishes between non-conforming goods and non-conforming documents of title and it has been argued<sup>103</sup> that it would be anomalous to insist on a strict conformity of documentary tender in the case of instalment sales and not in the case of an entire contract;
- (e) A similar question arises with respect to the seller's right to cure a defective title, or to remove an encumbrance or threatened interference with the buyer's quiet possession of his goods. UCC 2-508 is not in terms confined to physical defects — it speaks broadly of a "non-conforming" tender — and there is no good reason why it should be so confined. A strong argument has been advanced<sup>104</sup> in favour of the right to cure a defect in title and there is much to be said in its favour;
- (f) Does the subsection apply where the buyer partially accepts and partially rejects the tender? Since UCC 2-601 clearly recognizes

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<sup>101</sup>In *Wilson v. Scampoli* (1967), 228 A. 2d 848 (D.C.C.A.), the Court, while admitting that the construction was not free of difficulty, reached the latter conclusion.

<sup>102</sup>The "major-minor" defect test is criticized in Philips, "Revocation of Acceptance and the Consumer Buyer" (1970), 75 Com. L.J., 354, and in Comment, footnote 99 *supra*. A widely accepted test is the so-called "shaken faith" doctrine usually associated with *Zabriskie Chevrolet Inc. v. Smith* (1968), 240 A. 2d 195 (N.J.). A third test, involving the determination whether cure would cause the buyer "great inconvenience, risk or loss" has been put forward by Professor Hawkland, footnote 99 *supra*, at p. 724, and was adopted by the court in *Wilson v. Scampoli*, footnote 101 *supra*.

<sup>103</sup>See, Peters, footnote 99 *supra*, at p. 214.

<sup>104</sup>See, Hawkland, footnote 99 *supra*.

the right of partial rejection, the answer presumably is in the affirmative; and,

- (g) Finally, it is unclear whether the right to cure also applies to a revocation of acceptance. A commentator has pointed out<sup>105</sup> that some courts have acted as if it did, but this conclusion runs counter to a literal reading of UCC 2-508.

None of the above questions is designed to cast doubt on the general value of a cure provision. They merely illustrate the need for further clarification. As a concept the right to cure provides the seller with an important opportunity to remedy his breach without frustrating the reasonable expectations of the buyer, or requiring him to assume unbargained-for risks.

### (c) THE ULIS AND UNCITRAL APPROACHES

#### (i) *ULIS*

The buyer's right to reject a non-conforming tender is dealt with under several headings in the Uniform Law on the International Sale of Goods,<sup>106</sup> but a consistent theme runs throughout the remedial provisions. Regardless of how the seller's breach arises, and subject to the qualifications noted immediately below, the buyer is only entitled to avoid the contract where the seller's default amounts to a fundamental breach of his obligations.<sup>107</sup> The Uniform Law, therefore, rejects the perfect tender rule in its entirety and does not simply hedge it with important exceptions and restrictions, as does Article 2. However, the dichotomy between fundamental breaches and lesser breaches is not complete. The Uniform Law adopts, with important modifications, the German concept of "Nachfrist"<sup>108</sup> and entitles the buyer to avoid the contract where he has afforded the seller an additional period of time of reasonable length to cure an existing default.<sup>109</sup> Article 10 defines fundamental breach as follows:

For the purpose of the present law, a breach of contract shall be regarded as fundamental wherever the party in breach knew, or ought to have known, at the time of the conclusion of the contract, that a reasonable person in the same situation as the other party would not have entered into the contract if he had foreseen the breach and its effects.

The test has been criticized as unworkable,<sup>110</sup> and it may be so; but it is not irrational. In fact, it bears a remarkable resemblance to the classic test of a condition formulated by Bowen, L.J., in *Bentsen v. Taylor, Sons*

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<sup>105</sup>Comment, footnote 99 *supra*, at pp. 145-47.

<sup>106</sup>See, Arts. 20-32 (breach with respect to date or place of delivery), and Arts. 33-49 (breach with respect to quantity, description, quality or fitness of goods).

<sup>107</sup>Arts. 26, 30, 43, 45.

<sup>108</sup>As to which see, *supra*, ch. 16, sec. 1.

<sup>109</sup>Arts. 27(2), 31(2), 44(2).

<sup>110</sup>Graveson, Cohn, & Graveson, *The Uniform Laws on International Sales Act 1967* (1968), pp. 55-57.

& Co.<sup>111</sup> The sponsors of the Uniform Law appear to have attempted to integrate the test to determine the quality of a breach with the test to determine the measure of damages recoverable for breach of the seller's obligations.<sup>112</sup> Under the Uniform Law the test of reasonable foreseeability applies to each case.<sup>113</sup>

A number of other features of the Uniform Law deserve to be noted as illustrating possible solutions in relation to other aspects of the buyer's right to reject, discussed in earlier parts of this chapter. Article 37 entitles the seller to cure an imperfect tender, if he has handed over the goods before the date fixed for delivery, provided that he can do so without causing the buyer "unreasonable inconvenience or unreasonable expense". Article 37, therefore, substantially corresponds to UCC 2-508 (1), but this Article is subject to the qualifications just noted. Article 44 is the counterpart to UCC 2-508(2) and provides that:

44.1. In cases not provided for in Article 43, the seller shall retain, after the date fixed for the delivery of the goods, the right to deliver any missing part or quantity of the goods or to deliver other goods which are in conformity with the contract or to remedy any defect in the goods handed over, provided that the exercise of this right does not cause the buyer either unreasonable inconvenience or unreasonable expense.

2. The buyer may however fix an additional period of time of reasonable length for the further delivery or for the remedying of the defect. If at the expiration of the additional period the seller has not delivered the goods or remedied the defect, the buyer may choose between requiring the performance of the contract or reducing the price in accordance with Article 46, or provided that he does so promptly, declare the contract avoided.

Article 43 deals with the buyer's right to reject for fundamental breaches. It will be seen, therefore, that the right to cure after the contractual date for delivery is, by Article 44(1), restricted to lesser breaches. Article 44 also differs from the Code provisions in this respect: the seller's right to cure is not contingent on his having reasonable grounds for belief that the tender will be acceptable. It is, rather, limited by the same restrictions of inconvenience and unreasonable expense as apply in Article 37.

The buyer's right of examination, and the right to reject for a latent

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<sup>111</sup>[1893] 2 Q.B. 274 (C.A.), at p. 281: "In order to decide this question of construction, one of the first things you would look to is, to what extent the accuracy of the statement — the truth of what is promised — would be likely to affect the substance and foundation of the adventure which the contract is intended to carry out. There, again, it might be necessary to have recourse to the jury. In the case of charterparty it may well be that such a test could only be applied after getting the jury to say what the effect of a breach of such a condition would be on the substance and foundation of the adventure; not the effect of the breach which has in fact taken place, but the effect likely to be produced on the foundation of the adventure by any such breach of that portion of the contract."

<sup>112</sup>The damage rules appear in Arts. 82-89.

<sup>113</sup>Arts. 10, 82, 86.

defect, are dealt with in Articles 38 and 39. The problems of acceptance encountered in the common law are neatly avoided by conferring upon the buyer a right of examination that is not confused with questions of title and that does not turn on whether the buyer has done an act inconsistent with the ownership of the seller. The buyer is under a duty to examine the goods, or to cause them to be examined, promptly.<sup>114</sup> The examination, however, may take place, in the case of the carriage of the goods, at the place of destination or, if the seller knew or ought to have known that the goods might be redispached without trans-shipment, at the new destination.<sup>115</sup> This provision resolves, in simple fashion, the issue that so much troubled the English Court of Appeal in *Hardy & Co. v. Hillerns & Fowler*.<sup>116</sup> So far as the right to reject for latent defects is concerned, the draftsmen did not see this issue as posing any special problems. Should there be a latent defect, the buyer apparently retains his right to declare the contract avoided, provided that he gives the seller prompt notice of the defect after its discovery.<sup>117</sup> Since the Uniform Law has no concept of acceptance, it also has no need for a doctrine of revocation of acceptance. Accordingly, the distinction drawn by UCC 2-601 and UCC 2-608 between the initial right of the buyer to reject non-conforming goods and his right to revoke acceptance forms no part of the Uniform Law. It follows, therefore, that under the Uniform Law the quality of the breach required to justify avoidance on account of a latent defect is no higher than that required in other cases; but this departure from UCC 2-608 is more apparent than real. The reason is that under the Uniform Law the right of avoidance only arises where there is a fundamental breach, or where the seller has failed to cure when called upon to do so by the buyer.

(ii) *Draft UNCITRAL Convention*

The provisions on buyer's remedies in the 1977 draft Convention of the United Nations Commission on International Trade Law differ both in organization and in many points of detail from the Uniform Law. The basic concepts, however, appear to be the same. The definition of fundamental breach in the draft Convention has been substantially modified<sup>118</sup> from the Uniform Law; but the concept of fundamental breach has been retained<sup>119</sup> as the touchstone in determining when the buyer may declare the contract avoided. Again, as in the Uniform Law, the buyer may fix an additional period of time of reasonable length<sup>120</sup> for "performance" by the seller of his obligations, and may avoid the contract, *inter alia*, if the seller has not "delivered" the goods within this period of time.<sup>121</sup> The seller,

<sup>114</sup>Art. 38(1).

<sup>115</sup>Arts. 38(2), 38(3).

<sup>116</sup>[1923] 2 K.B. 490 (C.A.).

<sup>117</sup>Art. 39(1).

<sup>118</sup>Art. 8.

<sup>119</sup>Art. 31.

<sup>120</sup>Art. 29(1).

<sup>121</sup>Art. 31(1)(b). Note, however, the difference between Art. 29(1) and Art. 31(1)(a). The former applies to "performance by the seller of his obligations"; the latter is restricted to failure by the seller to deliver the goods within the additional period of time fixed by the buyer.

too, retains a limited right to cure<sup>122</sup> if the buyer has not already avoided the contract and if, *inter alia*, the cure can be effected without such delay as will involve a fundamental breach. There would, therefore, appear to be important differences between the scope of the buyer's right to demand cure and the scope of the seller's right to offer cure.

(d) CONCLUSIONS WITH RESPECT TO RIGHTS OF REJECTION AND CURE

(i) *Right of Rejection*

From the foregoing recital it will be obvious that, under existing Ontario law, there are serious shortcomings with respect to the buyer's right to reject. It will also be clear that there are at least two important models on which a recasting of the applicable rules may be based. However, before canvassing the alternative solutions and offering our own recommendations, it may be useful to inquire what interests the law seeks to protect in conferring the right to reject and what prejudice may be caused to the seller if this right is granted too freely.

The following interests have been identified<sup>123</sup> as arguing in favour of the right to reject. First, in the case of cash sales, the denial of a right of rejection may impose a twofold hardship on the buyer: he would be required to become an involuntary creditor of the seller; and, he might experience difficulty in recovering damages from a defaulting seller who may be a long distance away. Secondly, it may be difficult for the buyer to compute damages accurately, even assuming the seller is within the jurisdiction or that the buyer has a right of set-off or reduction with respect to the unpaid balance of the price. Thirdly, there is the hardship to the buyer of requiring him to dispose of goods bought for use and not for resale. Finally, there is the danger that sellers will not take their contractual obligations seriously if there is no right to reject and if they can only be liable in damages.

A liberal right of rejection also poses difficulties from the seller's point of view that are at least as significant as, and perhaps more so than, those already identified as confronting the buyer. This is particularly true if the goods have been manufactured to the buyer's specification, if they have been shipped to a distant destination where there is no ready market for the goods or, if, in the case of commodities, there has been a substantial drop in price since the time of purchase. Even if the goods are of a standard type, the seller stands to suffer substantial distributive and allocative costs through being required to take back and dispose of goods that are no longer new;<sup>124</sup> and, if the defect is only of a minor character, the loss to him may greatly exceed the diminution in the value of the goods in the buyer's hands. Not surprisingly, therefore, commercial sale

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<sup>122</sup>Art. 30(1).

<sup>123</sup>Honnold, "Buyer's Right of Rejection" (1949), 97 U. Pa. L. Rev. 457, at pp. 466-72. Compare, Treitel, "Some Problems of Breach of Contract" (1967), 30 Mod. L. Rev. 139, at pp. 149 *et seq.*

<sup>124</sup>See, Priest, footnote 87 *supra*, at pp. 963-68.

agreements<sup>125</sup> frequently contain important restrictions on the buyer's right to reject, or even deny this right altogether.

It will be obvious that the importance of these factors will vary greatly from case to case and that the picture will be further clouded by considerations such as the character of the buyer or seller, the nature of the goods, the terms of payment, and the time when the buyer seeks to exercise the right of rejection. It would be a Herculean task for a general sales act to be so sensitively calibrated that it could provide the right mixture of solutions to meet every possible contingency. An attempt to do so would involve the draftsmen in an excessive and self-defeating amount of detail. In our view, therefore, the search should be for a flexible formula, supported by ancillary rules designed to strike a fair balance in the great majority of cases. By "fair balance" we mean a balance that minimizes costs to both parties and seeks to save the bargain if this can be done on acceptable terms.

This approach is clearly inconsistent with the adoption or retention of a rigid perfect tender rule, however it is expressed. It is sometimes said that a perfect tender rule leads to greater certainty and promotes greater respect for bargains. While this may be true for some transactions and for certain types of obligation, we are not aware of any empirical evidence that supports the general proposition. Even if greater certainty could be demonstrated, the price would be unacceptably high;<sup>126</sup> and this is shown by the increasing aversion of courts to attempts by buyers to reject for minor breaches,<sup>127</sup> and by the frequency with which standard form contracts restrict the right to reject. A more serious alternative would be an Article 2 type solution; that is, the retention of a perfect tender rule coupled with exceptions to the rule. We are not, however, attracted by this solution either. If American observers are correct in claiming that the exceptions have to all intents and purposes destroyed the rule, it seems better to recognize realities and not to confuse form with substance.

Accordingly, we are led to the conclusion that the buyer's right to reject a non-conforming tender, in the absence of contrary agreement, should be confined to substantial breaches of the seller's obligations and we so recommend.<sup>128</sup> We consider the desirable definition of "substantial breach" in chapter 18 of this Report. We would emphasize, however, that our recommendation, which is supported by a similar recommendation in

<sup>125</sup>*Infra*, this ch., Table 1, p. 462.

<sup>126</sup>"We suggest that this is one of the areas of the law where it is impossible to escape questions of degree, and any appearance of exactness is an illusion": Law Reform Commission, New South Wales, *Working Paper on the Sale of Goods* (1975), para. 13.17, p. 220.

<sup>127</sup>Honnold, footnote 87 *supra*, at pp. 461-66. Professor Priest, footnote 87 *supra*, at p. 995, found that in 62 decisions dealing with rejection announced between 1954 and 1976 rejection was only affirmed in 17 cases, or 27% of the total number. Successful rejections were substantially higher in suits by consumer buyers (8 out of 18 suits, or 44%) than suits involving merchant buyers (9 out of 44 suits, or 20%). He also found (at p. 997), that the percentage of suits awarding revocation (55%) was substantially higher than the proportion of successful rejection claims (27%). UCC 2-608 only permits revocation where the non-conformity substantially impairs the value of the goods to the buyer.

<sup>128</sup>See, Draft Bill, s. 8.1.

the New South Wales Working Paper,<sup>129</sup> is consistent with our earlier recommendation with respect to the abolition of the existing *a priori* classification of contractual obligations,<sup>130</sup> and, subject to what we say hereafter about questions of cure, will place breaches by buyer and seller on the same footing. We are further of the opinion, as discussed earlier in this chapter, that the buyer's right to reject should not turn, as is the case under section 12(3) of the existing Sale of Goods Act, on whether, in a non-severable contract, the buyer has accepted part of the goods, or on whether the contract involves a sale of specific or non-specific goods or title has passed to the buyer. Accordingly, we recommend that the buyer should not lose his right to reject where he has accepted part of a non-severable consignment of goods; rather the revised Act should provide that, where the non-conformity amounts to a substantial breach, the buyer may accept the whole, reject the whole, or accept one or more commercial units and reject the rest.<sup>131</sup> In light of this recommendation, we recommend that section 29 of the existing Sale of Goods Act should be omitted from the revised Act. The Commission also recommends that the buyer should not lose his right to reject where the contract involves a sale of specific goods the title in which has passed to the buyer. Finally, a provision equivalent to section 12(3) of the existing Act should be omitted from the revised Act, and we so recommend.

(ii) *Seller's Right to Cure and Buyer's Right to Demand Cure*

The adoption of a substantial breach test to determine the buyer's right to reject a non-conforming tender does not end our inquiry. Two related matters need to be considered: namely, whether the seller, even after the buyer has exercised a right of rejection, should have an opportunity to cure the non-conformity; and, conversely, whether a buyer should be entitled *to demand* cure regardless of the gravity of the breach, and to reject the goods if the seller does not cure. While we are fully sensitive to the difficulties involved, we have reached the conclusion that both types of right should be recognized.

(1) *Seller's Right to Cure*

So far as the seller's right to cure is concerned, it has long been a common practice for contracts for the sale of durables and other types of goods to contain provisions entitling the seller to repair or replace defective goods and imposing corresponding restrictions on the buyer's right to reject. Table 1, which is based on an analysis of contract forms supplied to us by C.M.A. respondents, illustrates the widespread use of such provisions among Ontario manufacturers. A right to cure would, therefore, merely recognize an existing practice.

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<sup>129</sup>*Supra*, footnote 126, para. 13.39(c), and Draft Bill, s. 54A(9).

<sup>130</sup>See, *supra*, ch. 6, sec. B.

<sup>131</sup>See, Draft Bill, s. 8.1.

TABLE 1<sup>132</sup>

VENDOR'S LIABILITY FOR DEFECTIVE GOODS AND  
RIGHT TO CURE: INDUSTRY CLAUSES

*Key to clauses:* 10 — Liability limited to cost of goods.  
 11 — Liability limited to cost of repair of goods.  
 12 — Liability limited to replacement of goods.  
 13 — Vendor will at his option repair or replace parts  
 proven defective.

Industries using these clauses:

Food and Beverage	10, 13
Rubber and Plastic	10, 13
Leather	10
Knitting Mills	—
Furniture and Fixtures	10
Paper	10
Printing, Publishing and Allied Industries	10
Primary Metal	13
Metal Fabricating	10, 11, 12, 13
Non-Electrical Machinery	10, 11, 12, 13
Electrical Products	10, 12, 13
Non-Metallic Mineral Products	—
Petroleum and Coal Products	—
Chemicals	10
Miscellaneous Manufacturing	13

Again, there are important precedents for conceding such a right, including UCC 2-508, the provisions in ULIS and the draft UNCITRAL Convention,<sup>133</sup> and, in Canada,<sup>134</sup> the farm implements and agricultural machinery legislation of the Prairie provinces and Prince Edward Island. We appreciate that each of these precedents contains restrictions with respect to the types of breach, the types of goods, or other circumstances in which the right may be invoked. The adoption of a broad right to cure, on the other hand, is recommended in the New South Wales Working Paper.<sup>135</sup> The real question, it seems to us, is whether the statutory recognition of a general right to cure would militate unfairly against the buyer's interests and would add an element of uncertainty. We believe that, with proper

<sup>132</sup>This table is based upon Perell's "Analysis of Contractual Terms and Warranty Documents based on Materials received from O.L.R.C.-C.M.A. Questionnaire Respondents", Research Paper No. I.4. It should be emphasized that the analysis is based on forms voluntarily submitted to us and, since only a minority of the respondents supplied such documents, there is no claim that the analysis has any statistical validity. Nevertheless, we have reason to believe that the clauses are broadly representative of contractual practices in the industries concerned.

<sup>133</sup>*Supra*, this ch., pp. 454-59.

<sup>134</sup>See, Ontario Law Reform Commission, *Report on Consumer Warranties and Guarantees in the Sale of Goods* (1972), ch. 7, pp. 96-99.

<sup>135</sup>*Supra*, footnote 126, paras. 13.20 *et seq.*; and Draft Bill, ss. 54D and 54E.

safeguards, the right can be made to serve equitably the interests of both the buyer and the seller. Accordingly, subject to the recommendations made hereafter, we recommend that the revised Act should confer upon the seller a right to cure a non-conforming tender or delivery where the buyer has rightfully rejected or revoked his acceptance of the goods.<sup>136</sup> The safeguards we propose<sup>137</sup> are as follows: (i) that the seller must seasonably notify the buyer of his intention to cure the non-conformity, following the buyer's rejection; (ii) that the non-conformity can be cured without unreasonable prejudice, risk or inconvenience to the buyer; and (iii) that the type of cure offered by the seller is reasonable in the circumstances.

If the principle of a right to cure is conceded, then several consequential questions arise for decision. UCC 2-508, which is set out above, is the important provision of the Code that deals with the seller's right to cure an improper tender or delivery. In our discussion of these consequential issues, we make reference to this section.

(aa) *When Does the Right to Cure Arise?*

UCC 2-508(1) governs the right to cure a non-conforming tender or delivery that is made before the time for performance has expired. Section 2-508(2), on the other hand, confers a separate and more restricted right to cure when the contractual date for performance has expired. We do not think that this is a viable distinction. UCC 2-508(1), basing itself on common law precedents, seems to assume that no prejudice can be caused to the buyer by giving the seller an unqualified right to cure, provided that the conforming delivery is made within the contract time. As, however, the draft UNCITRAL Convention rightly perceives,<sup>138</sup> this assumption may not be correct, and we would collapse the distinction in UCC 2-508(1) and (2). Accordingly, we recommend that, subject to our recommendation made below in respect of a late tender or delivery amounting to a substantial breach, the right to cure should arise where the buyer rightfully rejects a non-conforming tender or delivery, whether before or after the time for performance has expired.<sup>139</sup> The safeguards that we have proposed would apply to each case. In practice, however, it may well be easier for the seller to discharge the onus imposed by the safeguards where the non-conforming delivery is made before, rather than at or after, the time for performance has expired; but this goes to proof and not to principle. We recommend<sup>140</sup> that the right to cure should also arise where, in accordance with a later recommendation, the buyer exercises a right to revoke his acceptance. The right to cure in such a case is particularly important because, at the time of revocation, the buyer may already have had the goods for a considerable period of time.

We have concluded that the treatment accorded to the seller's right

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<sup>136</sup>See, Draft Bill, s. 7.7(2).

<sup>137</sup>*Ibid.*

<sup>138</sup>Art. 30(1).

<sup>139</sup>See, Draft Bill, s. 7.7(2)(a).

<sup>140</sup>See, Draft Bill, s. 7.7(2)(b).

to cure a *late* tender or delivery should be different from that accorded to other non-conformities. We recommend that, if the late tender or delivery amounts to a substantial breach, then the seller, unlike the situation with other non-conformities, should not be allowed to cure.<sup>141</sup> It is our view that in the case of late tender or delivery amounting to a substantial breach, the need for certainty as to the position of the parties outweighs any other considerations and, therefore, that no right to cure ought to be available.

Later in this chapter, we recommend that the buyer should have a right to demand cure and, where the seller fails to cure, that the buyer should be able to treat the seller's breach as amounting to a substantial breach and to reject the goods. In our view, where the seller has failed to cure in response to a demand by the buyer, and the buyer accordingly exercises his right to reject, the seller should not be permitted to cure, and we so recommend.<sup>142</sup>

#### (bb) *Nature of Non-Conformity*

It will be noted that UCC 2-508 does not restrict the type of non-conforming tender that may be the subject of cure. Subject to what we have said above concerning late tender or delivery, we believe this approach to be the correct one. In particular there is no justification, in our view, for restricting the right to cure to physical or mechanical defects. The operative test should be, not the nature of the non-conformity, but whether the non-conformity can be cured without unreasonable prejudice, risk or inconvenience to the buyer. Accordingly, we recommend that, subject to our recommendation concerning the effect of a late tender or delivery on the seller's right to cure, the revised Act should not restrict the type of non-conforming tender that may be the subject of cure.

#### (cc) *Nature of "Cure"*

Given that the seller has a right to cure, there is the question of the nature or form that any adjustment or correction may take. As we have noted,<sup>143</sup> UCC 2-508 is vague on this point and it seems desirable that the permissible types of cure should be spelled out in some detail. In our view, they should be sufficiently flexible to match the broad range of non-conformities to which they will be applied. The New South Wales Draft Bill<sup>144</sup> contains an illustrative list, and we have adapted it to meet our own needs. Accordingly, we recommend that, for the purpose of the cure provisions, "cure" should mean:<sup>145</sup>

- (a) tender or delivery of any missing part or quantity of the goods;
- (b) tender or delivery of other goods or documents which are in conformity with the contract;

<sup>141</sup>See, Draft Bill, s. 7.7(2).

<sup>142</sup>See, Draft Bill, s. 7.7(3).

<sup>143</sup>See, *supra*, this ch., at p. 455.

<sup>144</sup>S.54D(2).

<sup>145</sup>See, Draft Bill, s. 7.7(1).

- (c) the remedying of any other defect, including a defect in title; or
- (d) a money allowance or other form of adjustment of the terms of the contract.<sup>146</sup>

Although the list seems to err on the side of generosity, we would emphasize that the seller will still be required to show that the proffered cure was reasonable in the circumstances.

(dd) *Status of Buyer's Obligations*

Since it is assumed that the buyer has rightfully rejected the tender or delivery, he should be entitled to suspend further performance of his obligations until the non-conformity has been cured. It is also implicit from our earlier recommendations<sup>147</sup> that the risk of loss will remain with the seller until he makes a conforming tender or otherwise cures his default. Likewise, in the absence of contrary agreement, the seller should remain liable for damages suffered by the buyer before cure. Accordingly, we recommend that, where the seller elects to cure a non-conformity, the buyer should be entitled to suspend performance of his obligations until the non-conformity has been cured.<sup>148</sup> We further recommend that the seller's election to cure should not affect the buyer's right to recover damages in respect of the non-conformity.<sup>149</sup>

(2) *Buyer's Right to Demand Cure*

Earlier in this chapter, we recommended that the buyer's right to reject non-conforming goods should be confined to substantial breaches of the seller's obligations. The question we now consider is whether the buyer should be entitled to demand cure regardless of the gravity of the breach — that is, whether or not he has an initial right to reject — and to reject the goods if the seller does not cure.

It seems to us difficult to concede the seller's right to cure without conferring a corresponding right on the buyer to demand cure. An equally persuasive reason in favour of such a right is that it is often difficult for the buyer to determine whether he is confronted with a substantial or minor non-conformity. Assume that the contract of sale relates to a machine that the seller delivers to the buyer. Assume that the machine does not work. It may be impossible to determine the cause of the malfunction until the machine has been dismantled. Since the seller may be assumed to be more familiar with the goods than the buyer, it is not unreasonable to place on the seller the onus of correcting the defect or suffering the consequences. Accordingly, a majority of the Commission<sup>150</sup>

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<sup>146</sup>The Honourable J. C. McRuer would not allow cure in the form of a money allowance.

<sup>147</sup>*Supra*, ch. 11, sec. 2(d).

<sup>148</sup>See, Draft Bill, s. 7.7(7).

<sup>149</sup>*Ibid.*

<sup>150</sup>Two of the Commissioners, the Honourable G. A. Gale and the Honourable J. C. McRuer dissent from this recommendation. In the opinion of Mr. Gale and Mr. McRuer, the proposed provision would be unworkable. They would leave the question of the buyer's right to demand cure to agreement between the parties.

recommends that, whether or not the non-conformity is such as to entitle the buyer to reject the tender or delivery, the buyer should be able to require the non-conformity to be cured within a reasonable time. If the seller fails to cure a non-conformity in response to the buyer's demand, the buyer should be entitled to reject the tender or delivery and to exercise the same remedies as if the breach had amounted to a substantial breach of the seller's obligations.<sup>151</sup>

Once again it is noteworthy that written agreements and express warranties entitling or obliging the seller to repair or replace defective goods do not usually distinguish between major and minor defects. However, as in the case of the seller's right to cure, we recognize that an unfettered right to demand cure could lend itself to abuse. We, therefore, recommend that this right be subject to the same safeguards<sup>152</sup> as recommended in respect of the seller's right to cure. We further recommend that the same definition of cure should apply to the buyer's right to demand cure as we have earlier recommended should apply to the seller's right to cure. If the buyer cannot or does not wish to assume the onus of meeting these requirements, then it is still open to him to exercise his right to reject if the breach is substantial, and thus shift to the seller the burden of offering cure.

We have previously recommended that, if a buyer rightfully rejects the goods or revokes his acceptance and if the seller elects to cure the non-conformity, the buyer should be able to suspend performance of his obligations until the non-conformity has been cured.<sup>153</sup> Similarly, in the case of a substantial breach where the buyer demands cure, we think that the buyer should also be able to suspend performance of his obligations until the non-conformity has been cured, and we so recommend.<sup>154</sup> However, where the breach is non-substantial but the buyer nevertheless demands cure, we have concluded that the buyer should still be responsible for performing his obligations while awaiting cure. We therefore recommend that, in such a case, the buyer should not be able to suspend performance of his obligations pending cure by the seller.

Earlier in this chapter we discussed the desirability of conferring upon the buyer a right to demand cure where the seller fails to tender or deliver on the date or within the time provided in the contract. We have concluded that separate provisions should govern the buyer's right to demand cure in these circumstances. Accordingly, we recommend that, where the seller fails to tender or deliver the goods or document of title on the date or within the time provided in the contract, the buyer may fix a further reasonable period for the performance of either of such obligations. If the seller's failure is not cured by the seller within the further period, the buyer may treat the breach as a substantial breach.<sup>155</sup>

We have painted what may appear to be a complex picture, but we

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<sup>151</sup>See, Draft Bill, s. 7.7(5).

<sup>152</sup>See, Draft Bill, s. 7.7(4).

<sup>153</sup>See, Draft Bill, s. 7.7(7).

<sup>154</sup>*Ibid.*

<sup>155</sup>See, Draft Bill, s. 7.7(8).

would expect our combined recommendations to encourage a continuation of the best current practices; that is, good faith negotiations between the parties to reach an acceptable settlement.

## 2. FURTHER CONSIDERATION OF EXAMINATION, ACCEPTANCE AND REVOCATION OF ACCEPTANCE

In view of their close interaction, any attempt to revise the rules of rejection would be incomplete without a concurrent review of the buyer's right to inspect the goods before acceptance, and the related issues of acceptance and revocation of acceptance. We have previously noted several important defects in the current Anglo-Canadian position and we proceed now to discuss what changes are desirable in the light of the provisions of the Code and other suitable precedents.

### (a) PLACE OF EXAMINATION

Section 33 of the Ontario Sale of Goods Act deals with the rights of the buyer as to examination. We think it useful to set out this section once more. The section reads as follows:<sup>156</sup>

33.(1) Where goods are delivered to the buyer that he has not previously examined, he shall be deemed not to have accepted them until he has had a reasonable opportunity of examining them for the purpose of ascertaining whether they are in conformity with the contract.

(2) Unless otherwise agreed, when the seller tenders delivery of goods to the buyer, he shall, on request, afford the buyer a reasonable opportunity of examining the goods for the purpose of ascertaining whether they are in conformity with the contract.

As will be noted, section 33(2) assures the buyer a preliminary right of examination at the time of tender of the goods. Section 33(1) confers upon the buyer an alternative right of examination after actual delivery. The Act does not, however, stipulate in either case where the examination must take place. It was settled before 1893<sup>157</sup> that, *prima facie*, the place of delivery was also the appropriate place of examination, but important exceptions<sup>158</sup> were recognized, both before and under the *Sale of Goods Act*, which turn on the express or implied agreement of the parties, the place of delivery, or the nature of the goods. In particular, the *prima facie* rule does not appear to apply to overseas shipments.<sup>159</sup> These exceptions suggest that the absence of a clear statement in the Act has not caused any particular difficulty. This would be true had it not been for the decision of the English Court of Appeal in *Hardy & Co. v. Hillerns & Fowler*<sup>160</sup> which inferentially cast doubt on some of the earlier cases involving the place, as well as the time, of examination.<sup>161</sup> It seems desirable, therefore, to clarify the position in the revised Act.

<sup>156</sup>See, *supra*, this ch., sec. C.1(a)(ii), for the previous discussion of this section.

<sup>157</sup>*Perkins v. Bell*, [1893] 1 Q.B. 193 (C.A.).

<sup>158</sup>*Benjamin's Sale of Goods* (1974), para. 874.

<sup>159</sup>*Ibid.*, para. 1722 (f.o.b. contracts), para. 1601 (c.i.f. contracts).

<sup>160</sup>[1923] 2 K.B. 490 (C.A.).

<sup>161</sup>*Benjamin's Sale of Goods* (1974), p. 898, n. 92.

UCC 2-513(1) provides as follows:

2-513.(1) Unless otherwise agreed and subject to subsection (3), where goods are tendered or delivered or identified to the contract for sale, the buyer has a right before payment or acceptance to inspect them at any reasonable place and time and in any reasonable manner. When the seller is required or authorized to send the goods to the buyer, the inspection may be after their arrival.

It will be observed that the *prima facie* test of the place of delivery has been displaced in favour of "any reasonable place". The onus is clearly no longer on the buyer to show that his case comes within an exception to the common law rule. In a somewhat less favourable formulation Article 22 of the 1977 draft UNCITRAL Convention provides:

22.(1) The buyer must examine the goods, or cause them to be examined, within as short a period as is practicable in the circumstances.

(2) If the contract involves carriage of the goods, examination may be deferred until after the goods have arrived at their destination.

(3) If the goods are redispached by the buyer without a reasonable opportunity for examination by him and at the time of the conclusion of the contract the seller knew or ought to have known of the possibility of such redispach, examination may be deferred until after the goods have arrived at the new destination.

We prefer the Code's more flexible test, and accordingly recommend that the revised Act should adopt, in place of section 33 of the existing Sale of Goods Act, a provision similar to UCC 2-513(1) to the effect that, unless otherwise agreed and except in the case of documentary sales and delivery on C.O.D. or similar terms, the buyer is entitled before payment or acceptance of the goods to inspect them at any reasonable place and time and in any reasonable manner.<sup>162</sup> We recognize that the Code rule may appear unduly favourable to the buyer, and may not appear to take adequately into consideration the hardship to the seller of requiring him to assume responsibility for goods that are a long distance from the place of delivery at the time of the buyer's rejection, or that may be scattered among a series of sub-buyers. The problem is not a new one and merely reflects the difficulty of reconciling the conflicting interests of buyer and seller. It is not, however, correct to assume that the existing rule is really more favourable to the seller. Even under existing law, if it is too late for the buyer to reject, he should still be entitled<sup>163</sup> to include in his damages the costs of taking back the goods from a sub-buyer and disposing of them elsewhere if a sub-sale was within the contemplation of the parties. In monetary terms, therefore, and excluding special factors, the ultimate

<sup>162</sup>See, Draft Bill, s. 7.12(1) and (2). There is an exception for documentary sales and delivery on C.O.D. or similar terms because payment before inspection is consistent with these kinds of sales. UCC 2-513(3) contains a similar exception and, see, paragraph 5 of the Official Comment to UCC 2-513.

<sup>163</sup>See, *Molling & Co. v. Dean & Sons Ltd.* (1901), 18 T.L.R. 217 (D.C.).

result would not be very different than if the seller had to assume responsibility for the goods at the place of rejection. Finally, it should be noted that UCC 2-603 mitigates the hardship to the seller by requiring a merchant buyer to follow any reasonable instructions from the seller with respect to the goods, where the seller has no agent or place of business at the market of rejection. As will be indicated later, we support this provision.<sup>164</sup> The seller, of course, also retains his contractual right to impose restrictions on the buyer's right to reject and he would continue to enjoy this right under the revised Act.

(b) ACCEPTANCE OF GOODS

The term acceptance appears in several sections of the Ontario Sale of Goods Act,<sup>165</sup> but is not defined. However, whatever its meaning, there is no ambiguity about the consequences of deemed acceptance of the goods by the buyer after delivery: he loses his right to reject. It is important, therefore, to determine when such acceptance takes place. Section 34, some aspects of which we have earlier discussed, provides as follows:

34. The buyer shall be deemed to have accepted the goods when he intimates to the seller that he has accepted them, or when the goods have been delivered to him and he does any act in relation to them that is inconsistent with the ownership of the seller, or when, after the lapse of a reasonable time, he retains the goods without intimating to the seller that he has rejected them.

It will be noted that this section establishes three rules governing the circumstances in which the buyer will be deemed to have accepted the goods. The first rule (intimation of acceptance) is unobjectionable, but difficulties arise because of the second and third rules. For the moment we confine our attention to the second rule, the so called "inconsistent act" rule. This rule presents three major problems. First, as we have noted previously, it conflicts with the buyer's right under section 33 to a reasonable opportunity to examine the goods. Secondly, it is difficult in many instances to see how the buyer's act can be inconsistent with the seller's *ownership*, since title will usually have passed to the buyer when he receives the goods. The terminology has caused the courts much difficulty.<sup>166</sup> Arguably, this rule should be confined to situations in which title has not yet passed to the buyer, although it has not been so restricted by the courts. Finally, it is not obvious why title considerations should play any role in determining the buyer's right to reject. It cannot be said that the seller is prejudiced, because that determination cannot be made until the buyer actually purports to reject. Nor can it be said that any act

<sup>164</sup>*Infra*, this ch., sec. C.3(a).

<sup>165</sup>For example, s. 5(1), s. 19, Rule 4, ss. 26, 33, 34, 35, and 48(1). See, *Benjamin's Sale of Goods* (1974), para. 672; *Williston on Sales* (Rev. ed., 1948), sec. 482.

<sup>166</sup>See, for example, *Hardy & Co. v. Hillerns & Fowler*, [1923] 2 K.B. 490 (C.A.), *per* Bankes, L.J., at p. 496 and *Atkin, L.J.*, at pp. 498-99; and compare, *Kwei Tek Chao v. British Traders & Shippers*, [1954] 2 Q.B. 459, *per* Devlin, J., at pp. 487-88.

of ownership by the buyer amounts to a conscious waiver of his rejection rights, because that would clearly be fictitious.

UCC 2-606 is the provision of the Code that corresponds to section 34 of the Ontario Sale of Goods Act. Section 2-606 provides as follows:

2-606.(1) Acceptance of goods occurs when the buyer

- (a) after a reasonable opportunity to inspect the goods signifies to the seller that the goods are conforming or that he will take or retain them in spite of their non-conformity; or
- (b) fails to make an effective rejection (sub-section (1) of Section 2-602), but such acceptance does not occur until the buyer has had a reasonable opportunity to inspect them; or
- (c) does any act inconsistent with the seller's ownership; but if such act is wrongful as against the seller it is an acceptance only if ratified by him.

(2) Acceptance of a part of any commercial unit is acceptance of that entire unit.

Paradoxically, UCC 2-606, in listing the circumstances in which acceptance occurs for the purposes of Article 2, has resurrected some of the same difficulties that occur under *The Sale of Goods Act*, since subsection 1(c) retains, in substantially similar language, the inconsistent act rule. Not surprisingly, the subsection is also causing the American courts much difficulty,<sup>167</sup> particularly since it contains no rule to determine priority between the buyer's right to a "reasonable opportunity" to inspect the goods and the inconsistent act rule, as does the amended version of section 35 of the U.K. *Sale of Goods Act*.<sup>168</sup> The Code's retention of this feature of pre-Code law is surprising for two reasons: first, because it is at variance with Article 2's philosophy that title rules are irrelevant in determining the rights and duties of the parties *inter se*; and, secondly, because the inconsistent act rule does not appear in UCC 2-608 governing the buyer's right to revoke his acceptance.

Our view is, therefore, that neither the Code provisions nor section 34 of the Ontario Sale of Goods Act are satisfactory in their present form. We recommend instead the adoption of the following provisions in the revised Act;<sup>169</sup>

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<sup>167</sup>White & Summers, *Handbook of the Law Under the Uniform Commercial Code* (1972), sec. 8-2, especially at pp. 251-53.

<sup>168</sup>Section 35, as amended by the words in square brackets, reads:

The buyer is deemed to have accepted the goods when he intimates to the seller that he has accepted them, or [(except where section 34 of this Act otherwise provides)] when the goods have been delivered to him, and he does any act in relation to them which is inconsistent with the ownership of the seller, or when after the lapse of a reasonable time, he retains the goods without intimating to the seller that he has rejected them.

<sup>169</sup>See, Draft Bill, s. 8.6.

8.6.(1) The buyer shall be deemed to have accepted the goods,

- (a) where after a reasonable opportunity to inspect the goods he signifies to the seller that the goods are conforming or that he will take or retain them in spite of their non-conformity;
- (b) where he fails to make an effective rejection after he has had a reasonable opportunity to inspect the goods; or
- (c) where the goods are no longer in substantially the condition in which the buyer received them, but this clause does not apply to a change in the condition of the goods caused by their own defects or to casualty suffered by them while at the seller's risk.

(2) Acceptance of a part of a commercial unit is acceptance of the entire unit.

Subsections (1)(a) and (b) and subsection (2) are copied from UCC 2-606. Subsection (1)(c) is derived from UCC 2-608(2)<sup>170</sup> and replaces the "inconsistent act" provision of UCC 2-606(1)(c). It will be observed that we have not followed the U.K. precedent in subordinating the inconsistent act rule (contained in section 34 of the Ontario Act) to the buyer's right of examination (contained in section 33 of the Ontario Act). In our view, three reasons militate against this approach. First, the U.K. amendment raises difficult points of construction;<sup>171</sup> secondly, the amendment, according to the interpretation of one commentator,<sup>172</sup> has not gone far enough to protect the buyer's reasonable interests. Finally, we do not see what useful purpose is served in retaining the inconsistent act rule. If the reasonable time for examination has not yet elapsed, *ex hypothesi* the buyer should not be precluded from rejecting the goods because of some alleged inconsistent act; that is, assuming the seller is not prejudiced by it and that it does not interfere with the buyer's ability to return the goods in substantially their original condition, when he exercises his right of rejection. If, on the other hand, the reasonable time for examination has elapsed, the buyer loses his right to reject on this ground alone and there is no need to rely on any inconsistent act.

Our proposed revised version of UCC 2-606 will, we hope, remove the difficulties of the inconsistent act rule in cases where the conduct of the buyer occurs *before* he discovers the non-conforming character of the goods and exercises his right of rejection. What, however, if the conduct of the buyer occurs *subsequent* to rejection, and before the seller resumes possession of the goods? It might be argued that such conduct amounts to an affirmation of the contract and nullifies the rejection, and some Ameri-

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<sup>170</sup>UCC 2-608(2) reads as follows:

Revocation of acceptance must occur within a reasonable time after the buyer discovers or should have discovered the ground for it and before any substantial change in condition of the goods which is not caused by their own defects. It is not effective until the buyer notifies the seller of it.

<sup>171</sup>Atiyah, *The Sale of Goods* (5th ed., 1975), pp. 290 *et seq.*

<sup>172</sup>*Ibid.*

can courts have so held.<sup>173</sup> Subsection (2)(a) of UCC 2-602 provides as follows:

2-602.(2) Subject to the provisions of the two following sections on rejected goods (Sections 2-603 and 2-604),

(a) after rejection any exercise of ownership by the buyer with respect to any commercial unit is wrongful as against the seller;

In our view, this approach is too rigid. The buyer may have no intention to affirm; he may have invested his savings in an essential item (for example, a mobile home or a car) and may not be able to buy a replacement until his money is returned.<sup>174</sup> We believe that a court should be entitled to take such factors into consideration in determining the reasonableness of his conduct. Accordingly, we recommend that the revised Act should adopt a provision that is similar to, but more flexible than, UCC 2-602(2)(a), dealing with the effect, after rejection of the goods, of any exercise of ownership by the buyer. This provision should read:<sup>175</sup>

after rejection, use of the goods or other acts of ownership by the buyer are *prima facie* wrongful as against the seller but do not nullify the rejection unless the seller has been materially prejudiced thereby.

#### (c) REVOCATION OF ACCEPTANCE

As we have previously noted, another difficulty about sections 33 and 34 of the Ontario Sale of Goods Act is that they make no allowance for latent defects that come to light after a reasonable period of examination has elapsed. This issue raises a difficult policy question, because the longer the period of rejection, however it is designated, the greater the potential hardship to the seller in being required to take back the goods.<sup>176</sup> On the other hand, the hardship to the buyer in maintaining the existing rule is no less acute. The reason is that the rule appears to restrict the buyer's remedies in just those circumstances when a choice of remedies is important. Latent defects are often substantial defects.

A possible solution would be to vest in the court<sup>177</sup> the power to determine the most efficient remedy in any particular case. This solution would, however, generate a new set of costs, and would compel the parties to litigate any differences that they may have. Such a solution, therefore, can hardly be regarded as a generally suitable approach. Our own view is

<sup>173</sup>White & Summers, footnote 167 *supra*, p. 252, especially nn. 16-17.

<sup>174</sup>See, *Jorgensen v. Pressnall* (1976), 545 P. 2d 1382 (Ore. Sup. Ct.); *Davis v. Colonial Mobile Homes* (1975), 220 S.E. 2d 802 (N.C. Ct. App.); *Jones v. Abriani* (1976), 350 N.E. 2d 635 (Ind. Ct. App.). In all these cases use of the goods after revocation was held justifiable or unavoidable.

<sup>175</sup>See, Draft Bill, s. 8.2(2)(a).

<sup>176</sup>Hence Williston, footnote 42 *supra*, sec. 608, p. 344, oversimplifies the issue when he claims that the "remedy of rescission, if allowed at all, is allowed on broad principles of justice".

<sup>177</sup>As is true of the U.K. *Misrepresentation Act 1967*, c. 7, s. 2(2), in actions to rescind for misrepresentation.

that, on balance, the greater equities favour the buyer's position. UCC 2-608 contains the provisions of the Code dealing with the buyer's right to revoke his acceptance in whole or in part. Subject to the comments we make hereafter, we recommend<sup>178</sup> that a provision comparable to UCC 2-608 should be incorporated in the revised Act.<sup>179</sup> Section 2-608 reads as follows:

2-608.(1) The buyer may revoke his acceptance of a lot or commercial unit whose non-conformity substantially impairs its value to him if he has accepted it

- (a) on the reasonable assumption that its non-conformity would be cured and it has not been seasonably cured; or
- (b) without discovery of such non-conformity if his acceptance was reasonably induced either by the difficulty of discovery before acceptance or by the seller's assurances.

(2) Revocation of acceptance must occur within a reasonable time after the buyer discovers or should have discovered the ground for it and before any substantial change in condition of the goods which is not caused by their own defects. It is not effective until the buyer notifies the seller of it.

(3) A buyer who so revokes has the same rights and duties with regard to the goods involved as if he had rejected them.

It will be observed that the section imposes a minimum of four conditions on the exercise of the remedy. The first condition is that the non-conformity must be substantial in character or, to be precise, must substantially impair the value of the goods to the buyer. This test is, of course, consistent with the general requirement of substantial breach that we have earlier recommended should be adopted for any right to reject, and calls for no further comment. A difficulty arises, however, because the section appears to measure the substantiality in subjective terms: "substantially impairs its value *to him*". This feature has rightly been criticized<sup>180</sup> and we recommend that the revised Act should not contain the words "substantially impairs its value to him", but should provide that the buyer may revoke his acceptance of a lot or commercial unit whose non-conformity "amounts to a substantial breach".<sup>181</sup>

The second condition requires the buyer to explain why revocation should be granted, and he may do so in one of three ways. The first way,

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<sup>178</sup>One of the members of the Commission, the Honourable J. C. McRuer, has reservations concerning the advisability of adopting a provision comparable to UCC 2-608.

<sup>179</sup>See, Draft Bill, s. 8.8.

<sup>180</sup>White & Summers, footnote 167 *supra*, p. 260; and see, also, *Schumaker v. Ivers* (1976), 238 N.W. 2d 284 (Sup. Ct. S.D.), at p. 287. Professor Priest notes, footnote 87 *supra*, at p. 994, that the subjective standard formed the basis of an award in only 2 out of 38 decisions involving the materiality of the defect.

<sup>181</sup>See, Draft Bill, s. 8.8(1).

provided in UCC 2-608(1)(a), has many familiar Canadian precedents<sup>182</sup> and involves a defect discovered by the buyer before acceptance, which the seller promises to cure but never does. In such circumstances it may be said that the buyer never really lost his right to reject; it was merely suspended pending the outcome of the seller's undertaking. The difficulty of discovering the defect before acceptance, which is dealt with in UCC 2-608(1)(b), constitutes the second way. It is this provision that introduces the really novel element from the point of view of Anglo-Canadian law. The third way in which a buyer may explain why revocation should be granted is also dealt with in UCC 2-608(1)(b), and relates to the "seller's assurances". This ground is more nebulous and, according to Official Comment 3, appears to involve inaccurate representations by the seller that the goods are conforming and, presumably, includes the familiar reassuring language of a seller that a defect is "nothing to worry about".

The third condition that must be satisfied is that the buyer must revoke his acceptance within a reasonable time after he discovers or should have discovered the non-conformity. This condition is as uncontentious as the two already discussed. The fourth condition is much more challenging. It is that revocation must occur "before any substantial change in condition of the goods which is not caused by their own defects". This important condition appears to have attracted remarkably little attention in the jurisprudence on UCC 2-608.<sup>183</sup> It seems clear, however, that mere use of the goods will not be a bar to the right of revocation; indeed, it could hardly be otherwise, since the right to revoke would then be of little value in the case of goods bought for use. Our own case law on rescission in equity for misrepresentation might provide some useful analogies. However this may be, it would be unwise, in our view, to attempt to define the meaning of "substantial change". So much will depend on a variety of factors, including the facts of the particular case, the type of goods, the conduct of the parties, and the time when the buyer seeks to revoke. UCC 2-608 does not expressly entitle the seller to a set-off or counterclaim in respect of the value of the buyer's use before revocation and, presumably, this is to be determined on general restitutionary principles. We return to this question in a later section of this chapter.<sup>184</sup>

Two further aspects of UCC 2-608 deserve mention. The first aspect is the absence of any explicit statement of the seller's right to cure. This omission would be rectified by the adoption of our earlier recommendation, that the seller should have a right to cure where the buyer revokes his acceptance of the goods.<sup>185</sup> The right to cure is of particular importance

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<sup>182</sup>For example, *Lightburn v. Belmont Sales Ltd.* (1969), 6 D.L.R. (3d) 692 (B.C.S.C.); *Rafuse Motors Co. v. Mardon Const. Ltd.* (1963), 41 D.L.R. (2d) 340 (N.S.C.A.); *Cain v. Bird Chevrolet-Oldsmobile Ltd.* (1976), 12 O.R. (2d) 532 (H.C.J.).

<sup>183</sup>The only case apparently cited in Duesenberg and King, *Sales and Bulk Transfers Under the Uniform Commercial Code*, Bender's Uniform Commercial Code Service, Vol. 3(A), (1978 Supp. to p. 14-20), is *U.S. v. Crawford* (1971), 8 U.C.C. Rep. 1210 (5th Cir.). White & Summers, footnote 167 *supra*, p. 255, mention the requirement, but do not pursue it.

<sup>184</sup>*Infra*, sec. E.

<sup>185</sup>See, Draft Bill, s. 7.7(2)(b).

when the buyer has had the goods for a substantial time, and it represents a desirable trade-off for the newly conferred right in the buyer's favour. The second aspect of UCC 2-608 raises a more difficult question. Since we have recommended the adoption of a substantial breach test to determine the buyer's right to reject, the right to revoke may appear redundant. The two rights, it may be thought, could be collapsed into a single right to reject, a right that would be exercisable after the buyer discovers or should have discovered the non-conformity, and that would be subject to the various safeguards recited in UCC 2-608. We have considered this possibility but, regretfully, have had to abandon it because of the important role of acceptance in determining the seller's entitlement to the price. Even if there were an integrated right to reject, it would still be necessary to establish rules to indicate the time of the seller's right to payment. The end result, therefore, would be the same as it is at present under the Code, unless the Code's price provisions were abandoned, which is a step that we do not recommend.

### 3. SOME CONSEQUENTIAL PROBLEMS FOLLOWING THE EXERCISE OF REJECTION RIGHTS; AND BUYER'S DUTY TO GIVE NOTICE OF BREACH AFTER ACCEPTANCE

We now turn to consider some consequential problems that arise once the buyer has exercised his right of rejection. We consider first the buyer's powers and obligations in respect of goods that he has rightfully rejected. We then discuss the buyer's duty to state the grounds of his rejection. We contrast the position of the buyer with his duty, after he has accepted the goods, to give notice of breach or notice of suit by a third party. Thereafter, we comment on the lien rights that the buyer has in respect of goods that he rightfully rejects. Finally, we express our opinion as to the extent to which the Code provisions should apply to wrongfully rejected goods.

#### (a) BUYER'S POWERS AND OBLIGATIONS WITH RESPECT TO GOODS

*The Sale of Goods Act*, like the common law it replaced, is parsimonious in spelling out the buyer's rights and obligations with respect to goods in his possession after they have been rightfully rejected by the buyer. Section 35 of the Act deals with the effect on the buyer of his refusal to accept goods. This section provides as follows:

35. Unless otherwise agreed, where goods are delivered to the buyer and he refuses to accept them, having the right so to do, he is not bound to return them to the seller, but it is sufficient if he intimates to the seller that he refuses to accept them.

This provision is more noteworthy for its omissions than for what it says. Section 35 fails to provide answers to important questions. It may be asked whether the buyer, if he has no obligation to do so, is at liberty to return or store the goods at the seller's expense, and whether he can act as agent of necessity and sell the goods if they are perishable in nature or subject to rapid price fluctuations. Further, is the buyer under an obligation to follow the seller's reasonable instructions with respect to the disposi-

tion of the goods? These are some of the questions that are left unanswered. Other consequential issues that arise will be considered hereafter.

The Code is substantially more forthcoming in providing answers to many of these questions. The Code's treatment begins with section 2-602 (2)(b) which obliges the buyer, after rejection, to hold the goods with reasonable care at the seller's disposition for a time sufficient to permit the seller to remove the goods. This substantially codifies both the common law position<sup>186</sup> and the rule adopted in section 69(1)(d) of the *Uniform Sales Act*. We recommend that a provision equivalent to UCC 2-602 (2)(b) should be incorporated in the revised Act.<sup>187</sup>

The important departures from the existing Anglo-Canadian position commence in UCC 2-603. This section, which deals with the position where goods have been rightfully rejected, provides as follows:

2-603.(1) Subject to any security interest in the buyer (subsection (3) of Section 2-711), when the seller has no agent or place of business at the market of rejection a merchant buyer is under a duty after rejection of goods in his possession or control to follow any reasonable instructions received from the seller with respect to the goods and in the absence of such instructions to make reasonable efforts to sell them for the seller's account if they are perishable or threaten to decline in value speedily. Instructions are not reasonable if on demand indemnity for expenses is not forthcoming.

(2) When the buyer sells goods under subsection (1), he is entitled to reimbursement from the seller or out of the proceeds for reasonable expenses of caring for and selling them, and if the expenses include no selling commission then to such commission as is usual in the trade or if there is none to a reasonable sum not exceeding ten per cent on the gross proceeds.

(3) In complying with this section the buyer is held only to good faith and good faith conduct hereunder is neither acceptance nor conversion nor the basis of an action for damages.

It will be noted that section 2-603 only applies to a merchant buyer and obliges him to follow any reasonable instructions from the seller, where the seller has no agent or office at the place of rejection and, in the absence of such instructions, to make reasonable efforts to sell the goods for the seller's account, if they are perishable or threaten to decline rapidly in value.<sup>188</sup> Predictably, if the buyer sells the goods he is entitled to recover his storage and selling expenses, and a sales commission corresponding to what is usual in the trade or, if there is no usual commission, to a reason-

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<sup>186</sup>Williston, footnote 42 *supra*, sec. 497.

<sup>187</sup>See, Draft Bill, s. 8.2(2)(b).

<sup>188</sup>Williston, footnote 42 *supra*, sec. 498; NYLRC Study, ch. 5, footnote 52, *supra*, pp. (517)-(518): "Under present law, the perishable nature of goods may give a wronged party a *privilege* of immediate resale which otherwise might not arise. However, the existence of a *duty* to dispose of defective rejected goods for seller is doubtful."

able commission not exceeding ten percent.<sup>189</sup> With UCC 2-603 should be read UCC 2-604. This latter section confers upon a buyer options as to salvage of rightfully rejected goods. UCC 2-604 provides as follows:

2-604. Subject to the provisions of the immediately preceding section on perishables if the seller gives no instructions within a reasonable time after notification of rejection the buyer may store the rejected goods for the seller's account or reship them to him or resell them for the seller's account with reimbursement as provided in the preceding section. Such action is not acceptance or conversion.

This section clarifies the uncertain common law<sup>190</sup> by entitling the buyer, whether or not he is a merchant, to store the goods, reship them to the seller or resell them, all at the seller's expense, even though the buyer is under no obligation to take such measures under UCC 2-603. Both these sections strike us as containing sensible and pragmatic rules. Accordingly, we recommend that the revised Act should contain provisions comparable to UCC 2-603 and UCC 2-604.<sup>191</sup>

Difficulties may, however, arise where the parties are not agreed as to the buyer's right to reject. In this situation either party may be afraid to act for fear of compromising his position. It will be noted that UCC 2-603(3) provides that the buyer is held only to good faith, and that good faith conduct under the provisions of the section "is neither acceptance nor conversion nor the basis of an action for damages." Under our recommended version of UCC 2-603(3), the buyer is placed under a duty to act in good faith and with reasonable care.<sup>192</sup> Though the merit of this provision seems readily apparent, it would not, by itself, provide a solution to the difficulty. Accordingly, in order to avoid such an impasse, we recommend that the revised Act should contain, in addition to provisions comparable to UCC 2-603(3) requiring that the buyer act in good faith and with reasonable care, a provision to the effect that, where the parties do not agree as to the buyer's right to reject the goods, any instructions given to, or action taken by, the buyer pursuant to the provision in the revised Act comparable to UCC 2-603(1) do not affect any other rights of the parties.<sup>193</sup>

(b) DUTY TO STATE GROUNDS OF REJECTION AND COMPARISON  
WITH BUYER'S DUTIES TO GIVE NOTICE OF BREACH  
OR SUIT BY THIRD PARTY

We now discuss the buyer's duty to state the grounds of his rejection, and compare it with his duties after he has accepted the goods to give notice of breach or notice of suit by a third party.

<sup>189</sup>UCC 2-603(2).

<sup>190</sup>Compare, Williston, footnote 42 *supra*, secs. 496-97 with *Benjamin's Sale of Goods* (1974), para. 875.

<sup>191</sup>See, Draft Bill, ss. 8.3 and 8.4.

<sup>192</sup>See, Draft Bill, ss. 8.3(5) and 8.3(6).

<sup>193</sup>See, Draft Bill, s. 8.3(4).

(i) *Duty To State Grounds of Rejection*

UCC 2-605 focuses upon a problem that attracted considerable judicial attention in the period preceding the adoption of the *Uniform Commercial Code*, but had not been dealt with in the *Uniform Sales Act*. Two questions arose: first, to what extent was a buyer obliged to give reasons for his refusal to accept goods; and, secondly, if the buyer had given reasons, could he add to the list at a later date? The Anglo-Canadian case law<sup>194</sup> apparently answers both questions in the buyer's favour. American judicial opinion was divided,<sup>195</sup> but at least agreed that the buyer would be estopped from raising unstated objections if his silence had prejudiced the seller's position. UCC 2-605(1) proceeds from the same premise and also confers affirmative rights of disclosure in favour of the seller. Subsection (1) provides as follows:

2-605.(1) The buyer's failure to state in connection with rejection a particular defect which is ascertainable by reasonable inspection precludes him from relying on the unstated defect to justify rejection or to establish breach

- (a) where the seller could have cured it if stated seasonably; or
- (b) between merchants when the seller has after rejection made a request in writing for a full and final written statement of all defects on which the buyer proposes to rely.

Subsection (2) adopts a more stringent rule and provides as follows:

(2) Payment against documents made without reservation of rights precludes recovery of the payment for defects apparent on the face of the documents.

Subsection (2) is supported by the recent decision of the English Court of Appeal in *Panchaud Frères S.A. v. Etab. General Grain Co.*<sup>196</sup> and we also support the subsection. Accordingly, we recommend that the revised Act should contain a provision comparable to UCC 2-605(2). We also recommend the adoption in the revised Act of a provision comparable to subsection (1)(a).<sup>197</sup> The justification for clause (b) of subsection (1) is less obvious and we do not recommend its adoption. It has been conjectured<sup>198</sup> that UCC 2-605(1)(b) may be a novel type of pre-trial discovery device but, if this is so, the objection may be made that, whereas UCC 2-605(1)(b) refers to a "full and final written statement of all defects on which the buyer proposes to rely", pleadings can usually be

<sup>194</sup>"[It] is clear . . . that [parties] are not, by their rejection of the tender on an insufficient ground, precluded from supporting the rejection on other and valid grounds": McCardie, J., in *Manbre Saccharine Co. v. Corn Products Co.*, [1919] 1 K.B. 198, at p. 204, quoted in Williston, footnote 42 *supra*, sec. 494b, p. 79.

<sup>195</sup>Williston, footnote 42 *supra*, secs. 494a-95; *Restatement of the Law of Contracts* (1932), sec. 304; NYLRC Study, ch. 5, footnote 52, *supra*, pp. (520) *et seq.*

<sup>196</sup>[1970] 1 Lloyd's Rep. 53 (C.A.).

<sup>197</sup>See, Draft Bill, s. 8.5.

<sup>198</sup>This is the conjecture of Professor Honnold. See, NYLRC Study, ch. 5, footnote 52, *supra*, pp. (522)-(523).

amended. A further difficulty about clause (b) is that it does not require the seller to show that he has been prejudicially affected by the buyer's failure to particularize. Again, since UCC 2-605(1)(b) only applies to defects discoverable by inspection of goods, it would not preclude a buyer from subsequently raising other defences; for example, that there was no binding contract because of conflicting terms in the parties' writings. The reported cases suggest that this type of defence is much more likely to arise in practice than a defence based on uncommunicated defects in the goods themselves.

(ii) *Comparison With Buyer's Duties To Give Notice of Breach After Acceptance, or to Give Notice of Suit By Third Party*

The buyer's duty to particularize his grounds of rejection under UCC 2-605 should be compared with his duties under UCC 2-607. Under UCC 2-607(3) a buyer has a duty to give notice, after the goods have been accepted, of any alleged breach of the seller's obligations, and has the additional duty to give notice of any action brought against the buyer for infringement of patent rights and the like. UCC 2-607(3) provides as follows:

2-607.(3) Where a tender has been accepted

- (a) the buyer must within a reasonable time after he discovers or should have discovered any breach notify the seller of breach or be barred from any remedy; and
- (b) if the claim is one for infringement or the like (subsection (3) of Section 2-312) and the buyer is sued as a result of such a breach he must so notify the seller within a reasonable time after he receives notice of the litigation or be barred from any remedy over for liability established by the litigation.

Clause (a) continues the policy embodied in section 49 of the *Uniform Sales Act*; clause (b) is new and was added in 1955, apparently at the request of the New York Patent Law Association.<sup>199</sup> Clause (a) is of particular importance and requires further consideration.

The provision has a curious history. The common law imposes no obligation on a buyer to give notice to the seller of a breach within any particular time after it first comes to his attention. Of course, the buyer still has to commence his action within the period provided by the legislation relating to the limitation of actions;<sup>200</sup> but that is a different matter. The notice requirement was first introduced in the United States by section 49 of the *Uniform Sales Act*. Williston<sup>201</sup> ascribes its introduction to the fact that, before the Act, the states were strongly divided with respect to

<sup>199</sup>*Ibid.*, pp. (529)-(530), (709)-(713).

<sup>200</sup>Normally six years in the Canadian common law jurisdictions. See, *The Limitations Act*, R.S.O. 1970, c. 246, s. 45(1)(g).

<sup>201</sup>Williston, footnote 42 *supra*, sec. 484a, pp. 37-38.

the effect of the buyer's acceptance on his right to sue for breach of contract. Some courts held that acceptance of title necessarily involved a release of the seller's liability for certain of his contractual obligations; others denied this effect, unless there was an intent to surrender the seller's obligations. According to Williston, section 49 was designed to relieve this uncertainty. Its purpose was, on the one hand, to prevent the hardship to the buyer of holding that acceptance involves surrender of his rights and, on the other hand, to avoid the hardship to the seller "of allowing a buyer at any time within the period of the Statute of Limitations to assert that the goods were defective, though no objection was made when they were received".<sup>202</sup> "With this in mind", adds Williston, "the positive requirement of prompt notice was inserted in the statute".<sup>203</sup>

The notice requirement did not escape criticism under the *Uniform Sales Act*, and it continues to be a centre of controversy in Article 2. The New York courts refused to apply the uniform provision in consumer cases.<sup>204</sup> Since the enactment of the Code, a large number of courts<sup>205</sup> have held that the notice requirement does not apply to a third party who claims to have been injured by the goods, although it is fairly clear that the Code draftsmen intended it to do so in a qualified form.<sup>206</sup>

These old and new reservations squarely raise the question whether a notice requirement should be adopted in the revised Ontario Act. In favour of the seller it may be argued that an unreasonable delay in notification prejudices his position. Such a delay would deprive the seller of an opportunity to verify the *bona fides* of the buyer's claim, and would encourage specious claims by debtors attempting to force a compromise or to postpone the payment of just debts. In favour of the buyer, especially the consumer buyer, it may be argued that he frequently would not be aware of the notice requirement, or not become aware of it until it is too late for him to comply, and that the introduction of the requirement could defeat meritorious claims on a minor technicality.

We are, therefore, of the view that, whatever conclusion may be reached with respect to the duty of notification by merchant buyers, it should not apply to consumer buyers. It appears to us that this position is consistent with the common law's antipathy towards disclaimer clauses in consumer transactions, and with the growing number of statutes that follow this lead. It is not necessary to consider separately the status of third parties who may wish to bring products liability claims, because it is

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<sup>202</sup>*Ibid.*, p. 38.

<sup>203</sup>*Ibid.*

<sup>204</sup>NYLRC Study, ch. 5, footnote 52, *supra*, p. (530), n. 340; Williston, footnote 42 *supra*, sec. 484b, p. 42.

<sup>205</sup>For example, *Fischer v. Mead Johnson Laboratories* (1973), 341 N.Y.S. 2d 257 (Ct. App.); *Bengford v. Carlem Corp.* (1968), 156 N.W. 2d 855 (Iowa Sup. Ct.); *Chaffin v. Atlanta Coca-Cola Bottling Co.* (1972), 194 S.E. 2d 513 (Ga. Ct. App.).

<sup>206</sup>UCC 2-607, Comment 5. For further discussions of the Code provisions and the judicial reaction, see Epstein, "Products Liability: Defenses Based on Plaintiff's Conduct" (1968), Utah L. Rev. 267, and Lidman, "Time Limitations on Warranties: Application and Validity under the U.C.C." (1970), 11 Boston College Industrial and Commercial Law Review 340.

generally agreed that claims of this nature should sound primarily in tort, rather than in contract. Such persons would, therefore, automatically be excluded from any notice requirement unless it were specifically extended to them. We do not favour such a step.

So far as merchant buyers are concerned, admittedly a much stronger case can be made in favour of a notice requirement.<sup>207</sup> Nevertheless, we have decided not to recommend a change in the existing position. We have three reasons for our conclusion. In the first place, we have lived without a notice rule for many years and no pressing case has been made for a change. The commercial community itself has not pressed for adoption of such a rule. Secondly, it is common for sales contracts to contain their own provisions with respect to time limitations for the making of complaints by buyers. It may be that some of the provisions are vulnerable on the ground of unconscionability,<sup>208</sup> and that others give rise to problems of interpretation. But at least they indicate that sellers are quite capable of protecting their own interests. Finally, whether the buyer is a consumer or merchant buyer, the seller should be able to invoke the new statutory doctrine of good faith, as well as common law and equitable principles of laches, waiver and estoppel, where the buyer has behaved unreasonably in delaying his complaint and the seller has been prejudiced as a result.

As noted above, UCC 2-607(3)(b) also obliges the buyer to notify the seller of any action for infringement "or the like" commenced against the buyer on pain of his being barred from any remedy over for liability established by the litigation if he fails to do so. Subsection (5)(b) further provides that, where such an action has been brought, the seller may demand that the control of the litigation be turned over to him. It will be observed that these provisions are restricted to infringement proceedings, and that they do not embrace other forms of claim against the buyer that may entitle him to seek indemnity from the seller. We are not aware of any need in Ontario to copy these features of UCC 2-607,<sup>209</sup> and we do not recommend their adoption in the revised Act.

We have reached the same conclusion with respect to UCC 2-607(5)(a) which gives statutory recognition to the "vouching in" procedure apparently first developed under the common law of the states.<sup>210</sup> Subsection (5)(a) provides that where the buyer is sued for breach of a warranty or other obligation for which his seller is answerable over, he may require the seller to come in and defend the action. If the seller fails to do so, he will be bound in any action against him by the buyer "by any determination of fact common to the two litigations". We see no advant-

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<sup>207</sup>Both ULIS, Art. 39, and the 1977 draft UNCITRAL Convention, Art. 23(1), contain such a requirement.

<sup>208</sup>See, for example, *R. W. Green Ltd. v. Cade Bros. Farms*, [1978] 1 Lloyd's Rep. 602 (Q.B.).

<sup>209</sup>Fox, *The Canadian Law and Practice relating to Letters Patent for Inventions*, (4th ed., 1969), p. 410, does not refer to the Code provisions; nor does he express dissatisfaction with the existing rules.

<sup>210</sup>NYLRC Study, ch. 5, footnote 52, *supra*, pp. (709)-(713); and see, James and Hazard, *Civil Procedure* (2nd ed., 1977), pp. 593-95. (The latter work does not discuss the Code provisions.)

age, and considerable disadvantage, in adopting this provision in Ontario and we do not recommend its incorporation in the revised Act. We have two reasons for this recommendation. The first reason is that the rules of court on third party actions<sup>211</sup> already cover the ground much more adequately. We see no point in introducing a second-tier procedure for contracts of sale. Our second reason is that the Code's vouching in procedure is seriously lacking in detail and confers few benefits on the buyer.<sup>212</sup> UCC 2-607(5)(a), it is true, dispenses with the need for the buyer to commence a formal third party action, but it does not give him the benefit of a judgment; nor does it resolve any issues between him and his seller, other than those issues of fact common to the two sets of claims. If the seller is uncooperative it seems all too likely that sooner or later the buyer will be forced to sue him after all. The buyer might as well resort from the beginning to a third party notice.

### (c) BUYER'S LIEN RIGHTS

Article 2 of the *Uniform Commercial Code* again departs from Anglo-Canadian sales law<sup>213</sup> in conferring upon the buyer a lien right in respect of goods in his possession that he rightfully rejects or in respect of which he justifiably revokes his acceptance. UCC 2-711(3) provides as follows:

2-711.(3) On rightful rejection or justifiable revocation of acceptance a buyer has a security interest in goods in his possession or control for any payments made on their price and any expenses reasonably incurred in their inspection, receipt, transportation, care and custody and may hold such goods and resell them in like manner as an aggrieved seller (Section 2-706).

This provision substantially re-enacts section 69(5) of the *Uniform Sales Act*, but differs from it in extending the buyer's lien to cover certain of his expenses in relation to the goods, as well as to secure the recovery of any payments made by him to the seller. It is difficult to gauge the practical importance of a buyer's lien right. It may well be of value to a merchant buyer who has storage facilities, who knows his rights, and knows where to find a market to enforce his lien if this becomes necessary. It seems less likely that a non-merchant buyer would often avail himself of the lien right: consumers as a group are usually only too happy to return to the seller goods that have proved unsatisfactory. However, it is generally agreed that the law should be evenhanded in conferring lien rights on buyers and sellers, and it seems equally reasonable to expect that the conferral of the buyer's lien right should not depend on the frequency with which this right is likely to be invoked by the buyer. We, therefore, recommend that a provision comparable to UCC 2-711(3) should be incorporated in the revised Ontario Act.<sup>214</sup>

<sup>211</sup>See, Rule 167 of the Supreme Court of Ontario Rules of Practice, R.R.O. 1970, Reg. 545, as am.; Holmsted and Gale, *Ontario Judicature Act and Rules of Practice*, Vol. 2, pp. 1224 *et seq.* (Rel. 3, Jan. 1976).

<sup>212</sup>Compare, NYLRC Study, ch. 5, footnote 52, *supra*, pp. (712)-(713).

<sup>213</sup>*J.L. Lyons & Co. v. May & Baker Ltd.*, [1923] 1 K.B. 685.

<sup>214</sup>See, Draft Bill, s. 9.13.

(d) TO WHAT EXTENT DO THE CODE PROVISIONS APPLY TO  
WRONGFULLY REJECTED GOODS?

A question that is not answered in Article 2 is the extent to which the provisions involving the buyer's rights and obligations with respect to rejected goods apply to wrongful rejections. In some contexts the answer is fairly clear. It seems obvious, for example, that a buyer in breach should not have lien rights.

The answer to this question is not, however, clear with respect to the provisions in sections 2-602, 2-603, and 2-604 of the Code. The captions to all three sections refer to "Rightful Rejection" or to "Rightfully Rejected Goods" although, with the exception of section 2-602(2)(c), the texts themselves are not restricted to such cases. In principle, it is difficult to see why a buyer who rejects effectively, but wrongfully,<sup>215</sup> should be in a better position than a buyer who has rejected rightfully. It may be that the captions do not accurately reflect the draftsmen's intentions but, whether this is so or not, we think that the text should be amended<sup>216</sup> to avoid any misunderstanding. The issue is of considerable importance because, as we have seen, under Article 2,<sup>217</sup> a buyer is not, generally speaking, liable for the price unless he has accepted the goods. The seller can no longer elect, as he could under the *Uniform Sales Act*,<sup>218</sup> between suing for the price once title has passed or suing for damages for refusal to accept. As a result, the seller is obliged to accept the return of even wrongfully rejected goods and will, therefore, want to know to what extent he can require the buyer's cooperation with respect to their custody, re-shipment, and disposition.

It may be objected that a wrongfully rejecting buyer should not be entitled to claim reimbursement of expenses and a selling commission, pursuant to UCC 2-603(2), if he follows the seller's instructions with respect to the disposition of the goods; for that would be to reward him for his wrongful act. The short answer to this objection would appear to be that the seller is not obliged to use the buyer's services. Moreover, in many cases the parties may disagree as to the rightfulness of the buyer's rejection, and it seems best not to delay the disposition of the goods until the merits of their respective positions have been established. If the seller is right, he will be entitled to recover, as part of his damages, any payments made by him to the buyer.<sup>219</sup>

The question whether the provisions of UCC 2-605 should apply where goods have been wrongfully rejected raises issues that are not easy to resolve. It would appear, *prima facie*, that a seller would not be prejudiced by the buyer's failure to particularize under this section. However, the lack of prejudice may only emerge after a lengthy court battle; and it is

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<sup>215</sup>As to the importance of this distinction under the Code, see, White & Summers, footnote 87 *supra*, at pp. 211-12.

<sup>216</sup>See, Draft Bill, s. 8.2(3).

<sup>217</sup>UCC 2-709(1).

<sup>218</sup>Ss. 63(1), 64(1), 65; and see, *The Sale of Goods Act*, ss. 47 and 48.

<sup>219</sup>See, Draft Bill, s. 8.3(4).

arguable, indeed, that the seller could be prejudiced. An earlier receipt of particulars might expedite the litigation and, in some instances, enable the seller to obtain a more speedy judgment. While we recognize that there is no obvious solution to this question we support the application of UCC 2-605 to cases of wrongful rejection.

In light of this discussion, we recommend that the provisions in the revised Act corresponding to UCC 2-602, UCC 2-603, UCC 2-604, and UCC 2-605 should also apply to goods wrongfully, but effectively, rejected by the buyer.

## D. THE BUYER'S CLAIM FOR DAMAGES

### 1. GENERAL PRINCIPLES OF LIABILITY — HAS THE PENDULUM SWUNG TOO FAR?

Whether or not the buyer has a right to reject non-conforming goods, and whether or not he chooses to exercise it, he is also entitled to claim damages. *The Sale of Goods Act* only concerns itself with damage claims sounding in contract, but section 57(1) preserves the rules of the common law except insofar as they are inconsistent with the express provisions of the Act. Although the right of a buyer to maintain an action for damages against the seller is conferred by two sections of the Act, the enumeration of contractual rights is not complete. Section 49 of the Ontario Sale of Goods Act deals with damage claims arising out of the seller's failure to deliver. This section provides as follows:

49.(1) Where the seller wrongfully neglects or refuses to deliver the goods to the buyer, the buyer may maintain an action against the seller for damages for non-delivery.

(2) The measure of damages is the estimated loss directly and naturally resulting in the ordinary course of events from the seller's breach of contract.

(3) Where there is an available market for the goods in question, the measure of damages is *prima facie* to be ascertained by the difference between the contract price and the market or current price of the goods at the time or times when they ought to have been delivered, or, if no time was fixed, then at the time of the refusal to deliver.

Section 51 of the Act is concerned with damage claims involving a breach of the seller's warranties or conditions where the buyer elects, or is obliged, to retain the goods. This section provides as follows:

51.(1) Where there is a breach of warranty by the seller, or where the buyer elects, or is compelled, to treat a breach of a condition on the part of the seller as a breach of warranty, the buyer is not by reason only of such breach of warranty entitled to reject the goods, but he may,

(a) set up against the seller the breach of warranty in diminution or extinction of the price; or

(b) maintain an action against the seller for damages for the breach of warranty.

(2) The measure of damages for breach of warranty is the estimated loss directly and naturally resulting in the ordinary course of events from the breach of warranty.

(3) In the case of breach of warranty of quality, such loss is *prima facie* the difference between the value of the goods at the time of delivery to the buyer and the value they would have had if they had answered to the warranty.

(4) The fact that the buyer has set up the breach of warranty in diminution or extinction of the price does not prevent him from maintaining an action for the same breach of warranty if he has suffered further damage.

The Act thus fails to deal explicitly with the right to claim damages following the rejection of non-conforming goods. A tender of non-conforming goods not accepted by the buyer is equivalent to no delivery at all and such a tender should, therefore, attract the provisions of section 49. Further, only by implication does the Act deal with the effect of a delayed delivery. It may also be noted that delayed delivery, breach of which is not waived, involves at least the breach of a warranty giving rise to a claim under section 51.<sup>220</sup>

The circumstances, therefore, that will trigger the buyer's contractual damage claims may differ widely. The measurement of damages is, however, governed by a unifying principle that has been part of sales law for well over a century. The aim of a damage award, it has frequently been said,<sup>221</sup> is to put the innocent party in the same position as if the contract had been performed. It may be contended that the language of this precept suggests a preoccupation with the protection of the innocent party's expectation interests; but the precept is open to an even more serious objection. It leaves the impression that the guilty party may be liable for an unlimited amount of damages so long as the award is necessary to make the innocent party whole. Of course, this is not the law. The seller is only liable for those damages that satisfy the foreseeability test as enunciated in *Hadley v. Baxendale*<sup>222</sup> and more recently refined by the House of Lords in *Koufos v. C. Czarnikow Ltd.*, also referred to as *The Heron II*.<sup>223</sup> In addition, the buyer has a duty to mitigate.

<sup>220</sup>Compare, *Benjamin's Sale of Goods* (1974), para. 1296, p. 635.

<sup>221</sup>See, for example, *British Westinghouse Electric & Manufacturing Co. Ltd. v. Underground Electric Railways Co. of London Ltd.*, [1912] A.C. 673 (H.L.), at p. 689; *Asamera Oil Corporation Ltd. v. Sea Oil & General Corporation and Baud Corporation N.V.* (1978), 23 N.R. 181, at p. 194 (S.C.C.).

<sup>222</sup>(1854), 9 Exch. 341. It will be observed that the rules in *Hadley v. Baxendale* combine the quantification of damages with questions of remoteness. Compare, Ogus, *The Law of Damages* (1973), at pp. 71-72. Depending on the context, "measure of damages" as used hereafter in the text may refer to either of these components in a damages issue.

<sup>223</sup>[1969] 1 A.C. 350 (H.L.).

The formulation of the test in its application to different circumstances will be examined presently. For the moment, suffice it to say that the two limbs of the test have been faithfully reproduced in the Ontario Sale of Goods Act. Section 49(2) tells us that in the event of non-delivery the measure of damages is the "estimated loss directly and naturally resulting in the ordinary course of events from the seller's breach of contract". Precisely the same test reappears in section 51(2) as the measure of the seller's *prima facie* liability for breach of warranty. Then section 52 completes the statutory reproduction by preserving the buyer's (and, equally the seller's) right to claim "special damages" where by law special damages may be recoverable. This is a reference to the so-called second rule of Baron Alderson in *Hadley v. Baxendale*.

Whatever reservations one may have about the terminology of general and "special damages" in this context,<sup>224</sup> it is abundantly clear that within generous limits the law seeks to protect the buyer's reliance, expectation and restitutionary interests. In practical terms this means that the seller may be liable for damages amounting to many times the price of the goods, and many more times the profit he could hope to derive from the transaction. The law reports are replete with examples of such awards. Equally serious from the seller's point of view is the fact that this potentially oppressive liability is not predicated on any form of moral culpability. Breach of a warranty or condition is a species of strict liability.<sup>225</sup> The seller cannot exonerate himself by showing that the breach could not have been prevented by the exercise of reasonable care on his part<sup>226</sup> and, indeed, that the breach could not even have been anticipated given the existing state of knowledge at the time that the contract was made.<sup>227</sup> Not surprisingly, sellers have an intense dislike for these principles of liability and seek to exclude or restrict them whenever they deem the danger of heavy damages sufficiently serious.

Has the pendulum swung too far in the buyer's favour? To put the issue on a broader footing, has the law erred in combining principles of strict liability for breach of contract with a concept of damages aimed at making the innocent party substantially whole? The answer to this question would involve an elaborate inquiry into society's reasons for enforcing contracts and the rationale of contract damages,<sup>228</sup> an inquiry that is

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<sup>224</sup>For the multiple meanings of "special damages", see, *McGregor on Damages* (13th ed., 1972), paras. 16-20. In the rules of pleading special damages denote out-of-pocket expenses which must be specially pleaded and itemized in the statement of claim. This distinguishes them from general damages which need not be specially pleaded and are deemed to be at large. The Code uses the term "consequential damages" in place of special damages in the contractual context; see, for example, UCC 2-715(2). In view of the ambiguity surrounding the latter term the Code usage is preferable and we have adopted it in the Draft Bill. See, Draft Bill, s. 9.19.

<sup>225</sup>*Randall v. Newson* (1877), 2 Q.B.D. 102(C.A.).

<sup>226</sup>*Frost v. Aylesbury Dairy Co.*, [1905] 1 K.B. 608(C.A.); *Buckley v. Lever Bros. Ltd.*, [1953] O.R. 704, [1953] 4 D.L.R. 16 (H.C.J.).

<sup>227</sup>*Henry Kendall & Sons v. William Lillico & Sons Ltd.*, [1969] 2 A.C. 31 (H.L.).

<sup>228</sup>As to which, see, Cohen, "The Basis of Contract" (1933), 46 Harv. L. Rev. 553; and Fuller & Perdue, "The Reliance Interest in Contract Damages: 1" (1936), 46 Yale L.J. 52, at pp. 57 *et seq.*

beyond the scope of this Report. It must suffice to indicate some of the relevant factors and some of the difficulties that are raised by this issue. It is frequently said that a modern economy could not function without the assurance that promises seriously made will be honoured and that the contract breaker will be held accountable in damages, or otherwise, if he violates his undertaking.<sup>229</sup> In economic terms, the legal norm is buttressed by the argument that enforceable promises lead to a more efficient allocation of resources<sup>230</sup> and reduce transaction costs. There are obvious weaknesses in these lines of reasoning. There is no necessary correlation between the enforceability of promises and the measure of damages awarded under the *Hadley v. Baxendale* principles. Nor is it true to say that an award of damages always promotes economic efficiency, or that such an award reflects a proper allocation of risks. In fact, the reverse may be true. If a small manufacturer is confronted with a large damage award in respect of a liability for which he is not insured, he may be forced into bankruptcy and his employees may lose their positions. It may be questioned whether such a result would necessarily promote economic efficiency or reflect proper allocation of risk. By the same token, resort to insurance principles as the basis for justifying heavy damage awards will not, for two reasons, pick up all the slack. The first reason is that insurance is not readily available for many types of pure economic losses. The second reason is that, at least in some instances, it may be easier and cheaper for the buyer to insure than for the seller.

Some of the early comments on the damage principles enunciated in *Hadley v. Baxendale* sought to allay these misgivings by arguing<sup>231</sup> that the party in breach must be deemed to have assumed the risk of foreseeable damages. Indeed, there have been intermittent suggestions<sup>232</sup> that the seller will not be held liable unless this assumption can be made. It is doubtful whether this is still the law,<sup>233</sup> and the tacit agreement test has been clearly rejected in Article 2<sup>34</sup> of the *Uniform Commercial Code*. However, an attenuated form of the test can be discerned in the Code's requirement that the damages sought to be recovered must have been within the contemplation of the parties as a substantial possibility,<sup>235</sup> the suggestion being that since the damages were foreseeable the party sought to be held liable could have refused to assume the risk. The notion that the seller's liability

<sup>229</sup>Compare, Fuller & Perdue, footnote 228 *supra*, at pp. 59-60.

<sup>230</sup>Posner, *Economic Analysis of Law* (2nd ed., 1977), especially sec. 4.9; Barton, "The Economic Basis of Damages for Breach of Contract" (1972), I. J. Leg. Studies 277.

<sup>231</sup>See, Gilmore, *The Death of Contract* (1974), pp. 50-51.

<sup>232</sup>*The British Columbia and Vancouver's Island Spar, Lumber and Saw Mill Co. Ltd. v. Nettleship* (1868), L.R. 3 C.P. 499, *per* Willes, J., at p. 509; *Elbinger A.G. v. Armstrong* (1874), L.R. 9 Q.B. 473, *per* Blackburn, J., at p. 478; Holmes, J., in *Globe Refining Co. v. Landa Cotton Oil Co.* (1903), 190 U.S. 540; *contra*, Lord Upjohn in *The Heron II*, footnote 223 *supra*, at p. 422.

<sup>233</sup>*McGregor on Damages* (13th ed., 1972), para. 194; and compare, Diplock L.J.'s description of the modern position in *The Heron II*, [1966] 2 All E.R. 593, at p. 603 (C.A.).

<sup>234</sup>UCC 2-715(2), and Comment 2.

<sup>235</sup>One of the tests favoured by several of the Law Lords as the test of foreseeability in *The Heron II*. See, further, *infra*, sec. D.3.

is based upon an implied assumption of risk raises difficult issues, but there is a more serious concern about the foreseeability tests. A seller can readily foresee that a defective machine will result in various types of loss to the buyer: what he cannot predict is the quantum of the prospective loss, a feature that, for legal purposes, is generally regarded as irrelevant.<sup>236</sup> Unless the seller has this information, it will be difficult for him to absorb the potential liability as part of the cost of his operations. The difficulties are compounded when the product is mass produced and mass distributed.

The broad principle of liability enshrined in the *Hadley v. Baxendale* formula is, therefore, vulnerable to criticism on important grounds. It is, however, easier to expose the weaknesses of the formula than to suggest alternatives that are not open to even greater objections. This appears to be true of the following solutions that suggest themselves as alternatives to the present scope of damage awards.

- (a) To disallow damage claims for breach of executory contracts, other than claims of a restitutionary character. Clearly, such a solution would be a regressive step in the evolution of contract law and would do nothing to encourage the observance of consensual obligations.
- (b) In the case of executed contracts, to restrict recovery to restitutionary and reliance losses, and to disallow all expectation losses save possibly where the seller has been guilty of negligence or wilful breach. This solution has a double weakness. It presupposes that an easy line can be drawn between reliance damages and expectation losses, and this is an assumption that does not correspond to the facts.<sup>237</sup> This solution also assumes that expectation losses constitute the most important component in a typical damage claim arising out of an executed contract, and this too is probably an overgeneralization.
- (c) To restrict the maximum recoverable damages to the value of the price or a multiple thereof unless the parties have agreed to a higher figure. This approach finds a precedent in many domestic and international contracts of carriage. It is also reflected in many sales contracts for manufactured goods that restrict the seller's liability to the repair or replacement of the defective goods, or to the return of the purchase price. The objection to this solution is that it may leave the buyer with ruinous consequential losses that he is ill-equipped to absorb.
- (d) To distinguish between consumer and commercial contracts and, on the ground that business buyers may be assumed to be capable of protecting their own interests, to allow a higher level of recovery for contracts of the former type. It is true that a distinction between consumer and non-consumer transactions has been widely drawn in recent consumer protection legislation. But this is done for the purpose of conferring *additional* protec-

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<sup>236</sup>*Wroth v. Tyler*, [1974] Ch. 30, 61.

<sup>237</sup>See, Fuller & Perdue, footnote 228 *supra*, at pp. 73-75.

tion on consumers, and not for the purpose of cutting down the rights that non-consumer classes enjoy under existing law.

- (e) To distinguish between economic losses and claims arising from injury to persons or damage to property, and to disallow the former losses and to accept the latter claims. There may, for various purposes, be good reasons for distinguishing between these two types of claim. To disallow economic claims altogether, unless expressly agreed to by the seller, would, however, be a solution that is open to even more serious objections than the preceding alternatives.

Having regard to the difficulty of finding an acceptable substitute, our conclusion is that the revised Act should continue to hold the seller liable for all substantially foreseeable damages falling within the *Hadley v. Baxendale* formula and we so recommend. We have also concluded that this formula should apply to the buyer's liability for damages. Whether any changes are desirable in the statutory reproduction of the formula will be considered hereafter.

The effect of this recommendation is to maintain the *status quo* and to impose on the seller the onus of disclaiming or restricting his liability within the limits permitted by the new law contained in the revised Act. Though this is an imperfect solution, it seems to us to be fairer than imposing on the buyer the onus of bargaining for the recovery of damages for the occurrence of which, *ex hypothesi*, he was in no way to blame. This is particularly true where the seller is a merchant selling goods to a non-merchant and is, therefore, more likely to be conversant with potential defects and risks of loss than the buyer. In reaching our conclusion we have also been influenced by the consideration that a change in basic damage principles, not applied uniformly across the contractual field, would disturb the existing equilibrium and would create serious anomalies. It should be clear from the preceding discussion that, under the scheme we propose, it would not be disreputable for a seller to seek to limit his liability and, provided it is not procured by unconscionable means, such allocation of risks should be respected by a court.

## 2. DAMAGE CLAIMS IN PRIVATE SALES

The existing law in respect of the assessment of damages does not distinguish between different types of seller. *Prima facie*, it may seem anomalous that the law should place damage claims against a private seller on the same footing as damage claims against a merchant seller. It may be thought that a persuasive case could be made for restricting the liability of a private seller to restitutionary damages, or, at any rate, to protecting him against claims for consequential damages in the absence of wilful breach of the contract, fraud or negligence. We have recommended in an earlier chapter<sup>238</sup> an expanded definition of express warranty. We noted that a representor (including a private seller) could be liable for expectation and reliance losses, and for consequential, as well as direct damages,

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<sup>238</sup>*Supra*, ch. 6, sec. A.

should there be a breach of an express warranty as so expanded. We considered the implications of this change of definition in the case of representations made by a private seller and the possibility of drawing a distinction between commercial and private sales. For reasons stated, we decided not to recommend an adoption of this distinction. We pointed out, however, that it may be that a different rule of damages should be adopted generally in non-commercial sales, and that we would explore this possibility at a later stage of this Report. We have reached that stage of the Report and we now turn to consider this more general issue.

The possibility that a private seller may be held liable for expectation and other non-restitutionary claims is not confined to breaches of an express warranty. The possibility also exists where he is sued for breach of any other contractual obligation, such as late delivery or breach of the implied conditions of title and description. The suggestion that a distinction should be drawn between the measure of the damages recoverable from a merchant seller and non-merchant seller is not novel since, with respect to latent defects in the goods sold, such a distinction already appears to exist in substance, if not in form, in various civil law systems.<sup>239</sup>

There are, however, persuasive reasons against the adoption of such a distinction in the revised Act. First, to the best of our knowledge, no other common law jurisdiction has so far introduced the distinction in its sales legislation and, in the context of express warranties, it was not supported in the New South Wales Working Paper.<sup>240</sup> Secondly, there is little evidence that the problem is a significant one. Most of the heavy damage claims appear to involve breaches of the conditions of merchantability and fitness, and these implied terms do not apply to private sales. Again, in so sensitive an area as damages, a flexible approach is preferable to a rigid distinction between different types of sale. Finally, it may be thought that if different damage rules are to be applied to private transactions the distinction should be drawn across a wider contractual area and not confined to sales law.

We are ourselves divided<sup>241</sup> about the merits of introducing the distinction in the revised Act, but we agree that this problem warrants further

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<sup>239</sup>Treitel, "Remedies for Breach of Contract", in *International Encyclopedia of Comparative Law*, Vol. VII, ch. 16, pp. 16-57 to 16-60. The distinction arises because the Codes frequently provide that consequential damages for latent defects are not recoverable unless the seller knew or is deemed to have known of the defect. See, for example, Code Civil (France), art. 1645, and Quebec Civil Code, art. 1527. There is a presumption that manufacturers and other professional vendors are deemed to know of the defect; hence a private or other non-professional vendor will ordinarily not be responsible for consequential damages. See, further, *Samson & Fillion v. The Davie Shipbuilding & Repairing Co.*, [1925] S.C.R. 202; *Touquette v. Pizzagalli*, [1938] S.C.R. 433.

<sup>240</sup>Law Reform Commission, New South Wales, *Working Paper on the Sale of Goods* (1975), pp. 250-53.

<sup>241</sup>Dr. D. Mendes da Costa, the Honourable G. A. Gale, and Mr. W. R. Poole, would favour a section in the Draft Bill that addresses this issue. The Honourable J. C. McRuer, Mr. W. G. Gray, and the Honourable R. A. Bell do not favour the matter being dealt with in the Draft Bill.

examination. Accordingly, we recommend<sup>242</sup> that it be remitted for this purpose to the Law of Contract Amendment Project.

### 3. THE COMPUTATION OF DAMAGES UNDER THE RULES IN *HADLEY V. BAXENDALE*: SOME PARTICULAR PROBLEMS

The existing damage principles in the Ontario Sale of Goods Act apply to claims both by a seller<sup>243</sup> and a buyer.<sup>244</sup> A striking feature of these principles is that they are cast in such broad and flexible language that the courts have been given great discretion to apply and adjust them, as they see fit, to the exigencies of particular circumstances. Substantially the same was true of the comparable provisions in the *Uniform Sales Act*<sup>245</sup> and is true, at least in terms of the buyer's damages, of the provisions in Article 2 of the *Uniform Commercial Code*.<sup>246</sup> This phenomenon raises two important questions. These questions are, to a large extent, common to claims by both a seller and a buyer and, for this reason, were not canvassed in our earlier discussion of seller's remedies in chapter 16. The first question is whether the revised Act should continue to leave the particularization of damage rules to the courts. The second question is whether there are significant shortcomings or ambiguities in the case law that require statutory reform or clarification. The following discussion focuses on some of the most important areas in which these questions arise for decision.

#### (a) THE FORESEEABILITY TEST

In the classic test propounded by Baron Alderson in *Hadley v. Baxendale*,<sup>247</sup> the types of recoverable damages were said to be such "as may fairly and reasonably be considered either arising naturally, *i.e.*, according to the usual course of things, from such breach of contract itself, or such as may reasonably be supposed to have been in the contemplation of both parties, at the time they made the contract, as the probable result of the breach of it". In *Victoria Laundry (Windsor) Ltd. v. Newman Industries Ltd.*, Asquith, L.J., in his second proposition neatly collapsed the two rules into one so as to produce the following felicitous formulation:<sup>248</sup>

. . . the aggrieved party is only entitled to recover such part of the loss actually resulting as was at the time of the contract reasonably foreseeable as liable to result from the breach.

Asquith, L.J., in his sixth proposition, also elaborated the meaning of foreseeability in the following passage:<sup>249</sup>

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<sup>242</sup>The Honourable G. A. Gale dissents from this recommendation. In his opinion the matter should be dealt with in the Draft Bill and there should be a distinction drawn between a merchant seller and a private seller.

<sup>243</sup>Sections 48 and 52.

<sup>244</sup>Sections 49, 51 and 52.

<sup>245</sup>Sections 64, 67, 69-70.

<sup>246</sup>UCC 2-713 to 2-715. See, Table 2, *infra*, pp. 494-96.

<sup>247</sup>(1854), 9 Exch. 341, at p. 354.

<sup>248</sup>[1949] 2 K.B. 528 (C.A.), at p. 539.

<sup>249</sup>*Ibid.*, at p. 540.

Nor, finally, to make a particular loss recoverable, need it be proved that upon a given state of knowledge the defendant could, as a reasonable man, foresee that a breach must necessarily result in that loss. It is indeed enough if he could foresee it was likely so to result. It is enough, to borrow from the language of Lord du Parcq . . . , if the loss (or some factor without which it would not have occurred) is a 'serious possibility' or a 'real danger'. For short, we have used the word 'liable' to result. Possibly the colloquialism 'on the cards' indicates the shade of meaning with some approach to accuracy.

As has been noted, the first rule in *Hadley v. Baxendale* is reproduced almost verbatim in the Ontario Sale of Goods Act<sup>250</sup> with respect to both the seller's and the buyer's recovery of damages. The second rule has been elliptically compressed in section 52 with the unhelpful observation that nothing "in this Act affects the right of the buyer or the seller to recover interest or special damages in a case where by law interest or special damages may be recoverable, . . .". It is not clear why Chalmers dealt with the second rule in such a negative way and we are of the opinion that the revised Act should state the parties' rights to recover special damages (that is, consequential damages) in more affirmative language, as is done in UCC 2-715(2) and other provisions of Article 2.<sup>251</sup>

It remains to be considered whether the formula for the recovery of damages is itself satisfactory. In *The Heron II*,<sup>252</sup> Lord Reid thought that the first rule of Baron Alderson was unsatisfactory and could not be taken literally. In Lord Reid's view it was obvious that Baron Alderson had not intended that every type of damage that was reasonably foreseeable by the parties when the contract was made, should either be considered as arising naturally (that is, in the usual course of things) or be supposed to have been in the contemplation of the parties. Lord Reid was also unhappy,<sup>253</sup> as were several of the other law lords,<sup>254</sup> with the reference by Asquith, L.J., to the test of foreseeability in the second of the propositions enunciated by him in the *Victoria Laundry* case. Lord Reid thought that this reference was calculated to confuse the measure of recovery in tort claims with those sounding in contract. Lord Reid also disagreed<sup>255</sup> with the second half of the sixth proposition of Asquith, L.J., wherein Asquith, L.J., measured the intensity of foreseeable losses necessary to satisfy the test as losses that were a "serious possibility", a "real danger", or "on the cards". Lord Reid felt these expressions were dangerously wide and extended the scope of the *Hadley v. Baxendale* principles as previously understood. In the opinion of Lord Reid<sup>256</sup> the test sanctioned by the jurisprudence, including in particular the earlier House of Lords decision of *Re R. & H. Hall Ltd. and W. H. Pim (Junior) & Co.'s Arbitration*,<sup>257</sup> was

<sup>250</sup>See, ss. 48(2) and 49(2).

<sup>251</sup>See, Draft Bill, s. 9.19.

<sup>252</sup>[1969] 1 A.C. 350, at p. 384.

<sup>253</sup>*Ibid.*, at p. 389.

<sup>254</sup>The other Law Lords who decided the case were Lord Morris of Borth-Y-Gest, Lord Hodson, Lord Pearce and Lord Upjohn.

<sup>255</sup>[1969] 1 A.C. 350, at p. 390.

<sup>256</sup>*Ibid.*, at p. 388. Compare, Lord Morris of Borth-Y-Gest, at p. 406.

<sup>257</sup>(1928), 33 Com. Cas. 324, [1928] All E.R. 763 (H.L.).

that an event was not too remote if it was not "unlikely to occur" or if there was "a very substantial degree of probability" that it might occur, even though the probability fell short of an even chance. The other Law Lords favoured such tests as "serious possibility", "real danger", "liable to result", or "not unlikely to result".<sup>258</sup>

It seems desirable that the test of foreseeability be amended in the revised Act, to take into account the refinements added by *The Heron II*, and we so recommend. Accordingly, with respect to buyer's damage claims, our Draft Bill contains the following reformulation of sections 49(2) and 51(2) of the present Ontario Sale of Goods Act:<sup>259</sup>

9.16(2) The measure of damages is the estimated loss which, having regard to the seller's knowledge of all the circumstances, he ought to have foreseen as likely to result from his breach of contract.

Likewise, with respect to damage claims of the seller for breach by the buyer the revised Act should contain a comparable reformulation of section 48(2) of the present Act.<sup>260</sup>

*The Heron II* did not deal with an important issue that arose for decision in the recent English Court of Appeal case of *H. Parsons (Livestock) Ltd. v. Uttley Ingham & Co. Ltd.*<sup>261</sup> The issue is whether the test of substantial foreseeability adopted by the House of Lords in *The Heron II* also applies where a plaintiff, in a claim for breach of warranty, seeks to recover damages for injury to person or property caused by defective goods. In the *Parsons* case the English Court of Appeal was divided in its views. Lord Denning, M.R., adopted the position<sup>262</sup> that where physical damages are involved the tort test of foreseeability should be applied whether the claim sounds in tort or in contract, and that *The Heron II* test should be confined to cases where only economic losses have occurred. Scarman, L.J., on the other hand,<sup>263</sup> did not feel that the cases justified a distinction in law between loss of profit and physical damage; nor did he think it necessary to develop the law judicially by drawing such a distinction. Orr, L.J., in a brief judgment, agreed with the reasoning of Scarman, L.J. Nevertheless, all three judges reached the same conclusion on the facts. The harmonization came about because Scarman, L.J., approved of the following statement in *McGregor on Damages*:<sup>264</sup>

. . . in contract as in tort, it should suffice that, if physical injury or damage is within the contemplation of the parties, recovery is not to be limited because the degree of physical injury or damage could not have been anticipated.

<sup>258</sup>[1969] 1 A.C. 350. See, Lord Morris of Borth-Y-Gest at p. 406; Lord Hodson at pp. 410-11; Lord Pearce at pp. 414-15; and Lord Upjohn at p. 425.

<sup>259</sup>See, Draft Bill, s. 9.16(2).

<sup>260</sup>See, Draft Bill, s. 9.10(2).

<sup>261</sup>[1977] 3 W.L.R. 990, [1978] 1 All E.R. 525 (C.A.); and see, Note, (1978), 94 L.Q.R. 171. See, also, *Asamera Oil Corporation Ltd. v. Sea Oil & General Corporation and Baud Corporation N.V.*, footnote 221 *supra*, at pp. 195-96.

<sup>262</sup>[1977] 3 W.L.R. 990, at pp. 996-99, [1978] 1 All E.R. 525 (C.A.), at pp. 531-34.

<sup>263</sup>*Ibid.*, especially at [1978] 1 All E.R. 535.

<sup>264</sup>(13th ed., 1972), para. 188.

On the facts before the Court, Scarman and Orr, L.JJ., agreed that the trial judge was justified in finding that there was a serious possibility of physical injury occurring, even though the magnitude of the injury or its precise character might not have been within the parties' contemplation.

The draftsmen of Article 2 of the *Uniform Commercial Code* anticipated the problem. UCC 2-715(2)(b) provides:

2-715.(2) Consequential damages resulting from the seller's breach include . . .

(b) injury to person or property proximately resulting from any breach of warranty.

It would appear that this test coincides with the approach of Lord Denning, and it is the test that also appeals to us. We, therefore, recommend that the revised Act should make it clear, as does UCC 2-715(2)(b), that where injury to person or property is alleged it is sufficient to show that the injury resulted proximately from breach of warranty.<sup>265</sup>

#### (b) COMPARISON WITH ARTICLE 2 PROVISIONS

Table 2 shows, at least in form, that the provisions of the *Uniform Commercial Code* have departed substantially from *The Sale of Goods Act* model with respect to the buyer's recoverable measure of damages.

TABLE 2

### BUYER'S DAMAGE REMEDIES

#### *Comparison of Sale of Goods Act and Article 2 Provisions*

##### *Sale of Goods Act*

##### *Article 2*

§.2-712. "Cover"; Buyer's Procurement of Substitute Goods

(1) After a breach within the preceding section the buyer may "cover" by making in good faith and without unreasonable delay any reasonable purchase of or contract to purchase goods in substitution for those due from the seller.

(2) The buyer may recover from the seller as damages the difference between the cost of cover and the contract price together with any incidental or consequential damages as hereinafter defined (Section 2-715), but less expenses saved in consequence of the seller's breach.

<sup>265</sup>See, Draft Bill, s. 9.19(2).

## Sale of Goods Act

Buyer may maintain action for non-delivery 49.—(1) Where the seller wrongfully neglects or refuses to deliver the goods to the buyer, the buyer may maintain an action against the seller for damages for non-delivery.

Measure of damages (2) The measure of damages is the estimated loss directly and naturally resulting in the ordinary course of events from the seller's breach of contract.

Difference in price (3) Where there is an available market for the goods in question, the measure of damages is *prima facie* to be ascertained by the difference between the contract price and the market or current price of the goods at the time or times when they ought to have been delivered, or, if no time was fixed, then at the time of the refusal to deliver.

Breach of warranty 51.—(1) Where there is a breach of warranty by the seller, or where the buyer elects, or is compelled, to treat a breach of a condition on the part of the seller as a breach of warranty, the buyer is not by reason only of such breach of warranty entitled to reject the goods, but he may,

(a) set up against the seller the breach of warranty in diminution or extinction of the price; or

(b) maintain an action against the seller for damages for the breach of warranty.

Measure of damages (2) The measure of damages for breach of warranty is the estimated loss directly and naturally resulting in the ordinary course of events from the breach of warranty.

Breach of warranty as to quality (3) In the case of breach of warranty of quality, such loss is *prima facie* the difference be-

## Article 2

(3) Failure of the buyer to effect cover within this section does not bar him from any other remedy.

### §.2-713. Buyer's Damages for Non-Delivery or Repudiation

(1) Subject to the provisions of this Article with respect to proof of market price (Section 2-723), the measure of damages for non-delivery or repudiation by the seller is the difference between the market price at the time when the buyer learned of the breach and the contract price together with any incidental and consequential damages provided in this Article (Section 2-715), but less expenses saved in consequence of the seller's breach.

(2) Market price is to be determined as of the place for tender or, in cases of rejection after arrival or revocation of acceptance, as of the place of arrival.

### §.2-714. Buyer's Damages for Breach in Regard to Accepted Goods

(1) Where the buyer has accepted goods and given notification (subsection (3) of Section 2-607) he may recover as damages for any non-conformity of tender the loss resulting in the ordinary course of events from the seller's breach as determined in any manner which is reasonable.

(2) The measure of damages for breach of warranty is the difference at the time and place of acceptance between the value of the goods accepted and the value they would have had if they had been as warranted, unless special circumstances show proximate damages of a different amount.

(3) In a proper case any incidental and consequential damages under the next section may also be recovered.

### §.2-717. Deduction of Damages From the Price

The buyer on notifying the seller

*Sale of Goods Act*

tween the value of the goods at the time of delivery to the buyer and the value they would have had if they had answered to the warranty.

Right of  
action

(4) The fact that the buyer has set up the breach of warranty in diminution or extinction of the price does not prevent him from maintaining an action for the same breach of warranty if he has suffered further damage.

Other  
rights of  
buyer  
pre-  
served

52.—Nothing in this Act affects the right of the buyer or the seller to recover interest or special damages in a case where by law interest or special damages may be recoverable, or to recover money paid where the consideration for the payment of it has failed.

*Article 2*

of his intention to do so may deduct all or any part of the damages resulting from any breach of the contract from any part of the price still due under the same contract.

### §.2-715. Buyer's Incidental and Consequential Damages

(1) Incidental damages resulting from the seller's breach include expenses reasonably incurred in inspection, receipt, transportation and care and custody of goods rightfully rejected, any commercially reasonable charges, expenses or commissions in connection with effecting cover and any other reasonable expense incident to the delay or other breach.

(2) Consequential damages resulting from the seller's breach include

- (a) any loss resulting from general or particular requirements and needs of which the seller at the time of contracting had reason to know and which could not reasonably be prevented by cover or otherwise; and
- (b) injury to person or property proximately resulting from any breach of warranty.

In the case of non-delivered or rejected goods, including goods rejected under a revoked acceptance, the first rule in *Hadley v. Baxendale* has, by UCC 2-713, been abandoned in favour of an apparently inflexible market price test, but subject to two qualifications: first, the buyer's right to elect to cover conferred by UCC 2-712; and, secondly, his entitlement to claim incidental and consequential damages under UCC 2-715. UCC 2-715(2) appears to merge the two rules in *Hadley v. Baxendale* into a single formula, but a formula that departs significantly from the test of foreseeability propounded in *The Heron II* in at least one and possibly two respects. First, read literally, clause (a) seems to suggest that, if the seller was aware at the time of contracting of the buyer's particular needs and requirements, he is liable for any loss, however improbable or unlikely.

There is nothing in the accompanying Comment to the section to indicate whether the draftsmen intended this wide a reading, although it seems unlikely. Secondly, in the case of injury to person or property, the seller's knowledge of special circumstances or foreseeability of risk of damage appears to be immaterial provided that such injury "proximately" results from the breach. We have already discussed the latter problem and it need detain us no further.

UCC 2-714 deals with the buyer's claim for damages in respect of accepted goods. The formula for measuring the buyer's consequential damages is the same as in the case of non-accepted goods; but the measure of direct damages is more flexible than in the case of undelivered or rejected goods. UCC 2-714(1) corresponds to section 51(2) of the Ontario Sale of Goods Act, except that the former embraces all damage claims for non-conforming tenders and is not confined to warranty claims. UCC 2-714(2) appears to be a fusion of the principles underlying sections 51(2) and (3) and 52 of *The Sale of Goods Act*. This reasoning is based upon the assumption that the words "unless special circumstances show proximate damages of a different amount" that appear in UCC 2-714(2) involve a substantial foreseeability test.

So far as its treatment of the *Hadley v. Baxendale* principles is concerned, there appear to be no obvious advantages in adopting the Article 2 provisions, UCC 2-713 and 2-715, in preference to sections 49 and 51 of the Ontario Sale of Goods Act. We, therefore, favour retaining the essential structure of sections 49 and 51,<sup>266</sup> subject to the two changes already recommended, and subject also to a number of other changes, not affecting the *Hadley v. Baxendale* principles, to be mentioned hereafter. Following UCC 2-714(1) we also recommend<sup>267</sup> that section 51 should be expanded to cover all claims for non-conforming tenders involving accepted goods, and that it should also incorporate the best features of UCC 2-714.

So far as the seller's or buyer's right to claim consequential damages is concerned, we believe that this right should be stated in more affirmative language as is done in UCC 2-715(2). However, Part 7 of Article 2 is excessively replete with references to the buyer's and to the seller's right to claim incidental and consequential damages. We think a single provision should suffice and we recommend<sup>268</sup> the adoption in the revised Act of the following provision to take the place of section 52 of the existing Sale of Goods Act and in preference to UCC 2-715(1) and (2)(a):

(1) A seller's or buyer's claim for damages may include a claim for incidental or consequential damages.

It will be recalled that we have already recommended that the revised Act should contain a provision corresponding to UCC 2-715(2)(b), to the effect that consequential damages include injury to person or property

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<sup>266</sup>See, Draft Bill, ss. 9.16, 9.17.

<sup>267</sup>See, Draft Bill, s. 9.17.

<sup>268</sup>See, Draft Bill, s. 9.19(1).

proximately resulting from a breach of warranty.<sup>269</sup> Except in the case of claims arising out of physical damage, we do not deem it necessary to spell out the circumstances in which consequential or incidental damages are recoverable, since they are already adequately covered by our recommended version of the *Hadley v. Baxendale* formula. Our draft provision makes no reference to a buyer's restitutionary claim, because this type of claim is covered separately in the Draft Bill.<sup>270</sup>

(c) THE RIGHT TO COVER

An important innovation<sup>271</sup> introduced by Article 2 of the *Uniform Commercial Code* is the buyer's right to "cover" the seller's failure to perform. By UCC 2-712, the buyer may "cover" by making in good faith and without unreasonable delay any reasonable purchase of or contract to purchase goods in substitution for those due from the seller, and may use the cover price in lieu of the traditional market price test to measure his damages. The full text of UCC 2-712 provides as follows:

2-712.(1) After a breach within the preceding section the buyer may 'cover' by making in good faith and without unreasonable delay any reasonable purchase of or contract to purchase goods in substitution for those due from the seller.

(2) The buyer may recover from the seller as damages the difference between the cost of cover and the contract price together with any incidental or consequential damages as hereinafter defined (Section 2-715), but less expenses saved in consequence of the seller's breach.

(3) Failure of the buyer to effect cover within this Section does not bar him from any other remedy.

The extent of the departure of UCC 2-712 from existing law must not, however, be exaggerated. If there is no available market,<sup>272</sup> the Anglo-Canadian courts have generally been willing in assessing damages to accept evidence of the actual price paid by the buyer for the same or substantially similar goods.<sup>273</sup> This form of cover is, therefore, already recognized. Our existing law is defective insofar as it does not appear to permit the buyer to base his damages on a covering transaction where there is an available market for the goods. The price he paid may be admissible as evidence of a prevailing market price, but it is not conclusive. Moreover, if a significant delay has occurred between the time of the seller's breach and the date of the buyer's cover, the evidence may not be admissible for even this limited purpose. It is in the context of an available market that UCC 2-712 serves its most useful office.

<sup>269</sup>*Supra*, this ch., at p. 494; and see, Draft Bill, s. 9.19(2).

<sup>270</sup>See, Draft Bill, s. 9.12(2)3 and s. 9.14, and *infra*, Part E.

<sup>271</sup>Professor Peters, footnote 99 *supra*, at p. 267, describes it as "one of Article 2's most significant achievements".

<sup>272</sup>The concept of "available market" and the existing statutory provisions relating to it are discussed *infra*, ch. 18, sec. 2.

<sup>273</sup>*Hinde v. Liddell* (1875), L.R. 10 Q.B. 265; *Casswell v. Mathew Moody & Sons Company*, [1926] 1 W.W.R. 113 (Sask. C.A.). Compare, *The Arpad*, [1934] P. 189 (C.A.).

Accordingly, we recommend that a provision corresponding to UCC 2-712(1) should be adopted in the revised Act permitting the buyer to cover his loss by making in good faith and without any unreasonable delay any reasonable purchase of or contract to purchase goods in substitution for those due from the seller where the seller's conduct amounts to a substantial breach and the seller repudiates, fails to make delivery or to perform an act due before delivery, or where the buyer rightfully rejects or revokes acceptance.<sup>274</sup> We further recommend that, where the buyer has elected to cover, he should be entitled, as in UCC 2-712(2), to recover as damages the difference between the cost of cover and the contract price less expenses, if any, saved in consequence of the seller's breach, but failure to cover should not bar the buyer from any other remedy.<sup>275</sup>

Our recommendation would not confer upon the buyer an unfettered right to elect between covering and basing his claim for damages on the test that we later recommend should be adopted in lieu of the traditional market price test.<sup>276</sup> If the buyer seeks to rely on the results of a covering purchase he is obliged to act in good faith and without unreasonable delay.<sup>277</sup> The concept of good faith requires that both the decision to cover and the terms of the substitutional contract must be honestly made, and that reasonable standards of fair dealing must be observed.<sup>278</sup>

An uncertainty that is not resolved in Article 2 is whether a buyer is bound by his election to cover. As we have previously noted, the same question arises with respect to a seller's resale under UCC 2-706 and we have earlier recommended that a seller should be bound by the results of the resale in claiming his damages.<sup>279</sup> We are of the view that the same principle should obtain in each case. Accordingly, we recommend that a buyer who elects to cover should be bound by the results of his election in claiming his damages. To ensure this result, the recommended general provision in our Draft Bill dealing with the computation and measure of the buyer's damages provides that the buyer is not entitled to sue for the difference between the contract price and the price that we later recommended for adoption in lieu of the market price, if his actual loss is less than this difference.<sup>280</sup>

#### (d) SUB-CONTRACTS, THE FORESEEABILITY TEST, AND MITIGATION PRINCIPLES

Under this heading we deal with two distinct questions, the answers to which remain uncertain. The first question is concerned with the situation where the buyer has entered into a sub-contract for the resale of the goods. The second question arises where the buyer actually resells the goods or enters into a compensating purchase.

<sup>274</sup>See, Draft Bill, s. 9.12(2) and s. 9.15(1).

<sup>275</sup>See, Draft Bill, s. 9.15(2) and (3).

<sup>276</sup>In chapter 18, sec. 2, we recommend that a test of 'commercially reasonable disposition or purchase' be substituted in the revised Act for the traditional market price test.

<sup>277</sup>See, Draft Bill, s. 9.15(1).

<sup>278</sup>See, Draft Bill, s. 1.1(1)15.

<sup>279</sup>*Supra*, ch. 16, sec. 2(b)(iii).

<sup>280</sup>See, Draft Bill, s. 9.16(4).

The first question is whether a disappointed buyer can claim enhanced damages on the ground that the seller's failure to perform caused him to lose a profitable sub-contract or on the ground that the seller's breach has involved him in damage claims brought by his sub-buyer. In *Williams Brothers v. Ed. T. Agius Ltd.*<sup>281</sup> the House of Lords approved the rule enunciated by the Court of Appeal in *Rodocanachi Sons & Co. v. Milburn Brothers*<sup>282</sup> that "the law does not take into account in estimating the damages anything that is accidental between the plaintiff and the defendant". This rule has been reaffirmed and followed in subsequent cases with the exception of the much discussed decision<sup>283</sup> of the House of Lords in *Re R. & H. Hall Ltd. and W. H. Pim (Junior) & Co.'s Arbitration*.<sup>284</sup> The controversial judgments in the *Hall* case discussing the test of foreseeability under the rules in *Hadley v. Baxendale* were quoted with approval in *The Heron II*, although in the latter case Lord Reid<sup>285</sup> was careful to reserve his opinion with respect to whether a different test of foreseeability applies in sales cases than applies in contracts for the carriage of goods and other branches of contract law.

This, indeed, is the critical issue. It appears to be well accepted that if the seller knows that the buyer needs the goods to meet an existing commitment,<sup>286</sup> or intends to resell them under a string contract,<sup>287</sup> he will be held responsible for the buyer's enhanced damages. Further, in *Patrick v. Russo-British Grain Export Co. Ltd.*<sup>288</sup> Salter, J., stated that it was sufficient if both parties contemplate that the buyer will "probably" resell on terms that will not enable the buyer to go into the market and replace the goods if the seller defaults, "and the seller is content to take the risk". On this basis it seems that the issue is narrowed to a choice between the test of "probable" resale and the broader test of "serious possibility", "real danger", "not unlikely occurrence" favoured by the members of the House of Lords in *The Heron II*.<sup>289</sup> It is understandable that the courts should be reluctant to saddle the seller with aggravated damages in the absence of compelling evidence that he appreciated the risk. At the same time it is difficult to justify a stricter test to measure the seller's liability for damages of this nature, than to measure his liability where other forms of damages are being claimed. Be that as it may, we are of the view that the discrepancy is one that is best left for judicial resolution. Accordingly, we recommend that the revised Act should not attempt to specify the circumstances, if any, in which the buyer may be entitled to recover enhanced damages on the ground that the seller's failure to perform has caused him to lose a

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<sup>281</sup>[1914] A.C. 510(H.L.).

<sup>282</sup>(1886), 18 Q.B.D. 67 (C.A.), at p. 77.

<sup>283</sup>See, for example, the discussion and authorities cited in *McGregor on Damages* (13th ed., 1972), paras. 569 *et seq.*; and Atiyah, footnote 171 *supra*, pp. 307-09.

<sup>284</sup>(1928), 33 Com. Cas. 324, [1928] All E.R. 763 (H.L.); *Benjamin's Sale of Goods* (1974), paras. 1288-91.

<sup>285</sup>[1969] 1 A.C. 350 (H.L.), at p. 393.

<sup>286</sup>*Household Machines Ltd. v. Cosmos Exporters Ltd.*, [1947] K.B. 217.

<sup>287</sup>*Kwei Tek Chao v. British Traders & Shippers Ltd.*, [1954] 2 Q.B. 459, at p. 489.

<sup>288</sup>[1927] 2 K.B. 535, especially at p. 540.

<sup>289</sup>[1969] 1 A.C. 350 (H.L.).

profitable sub-contract or on the ground that the seller's breach has involved him in damage claims brought by his sub-buyer.

The second question is the extent to which the seller can take advantage of the buyer's actual resale or compensating purchase, as the case may be, in order to show that the buyer's actual loss was *less* than the figure that would otherwise be arrived at by the market price formula.<sup>290</sup> The rule in the *Rodocanachi* case, just referred to, does not furnish an automatic answer to this question, because it fails to take into account the buyer's general obligation to mitigate his damages, which arises *after* he has learned of the seller's breach.<sup>291</sup> The point does not appear to be covered by authority,<sup>292</sup> but textwriters generally take a negative view.<sup>293</sup> We have earlier recommended that a provision equivalent to UCC 2-712, which confers upon the buyer a right to "cover", should be incorporated into the revised Act.<sup>294</sup> If this recommendation is accepted, then the mitigation issue will resolve itself in cases where the buyer has made a compensating purchase. The reason is that the covering price will measure the extent of the buyer's damages, whether the price is lower or higher than the prevailing market price.

Our recommended right to cover does not, however, provide a complete answer to the broad policy issue presented by the question under discussion. The right to cover is by its nature limited to a post-breach event and does not relate to events that occur prior to breach. To what extent should evidence of such pre-breach events be admissible? Our response to this policy issue is contained in our Draft Bill<sup>295</sup> which, following the controversial decision of the Privy Council in *Wertheim v. Chicoutimi Pulp*

<sup>290</sup>*McGregor on Damages* (13th ed., 1972), paras. 238 *et seq.*

<sup>291</sup>However, in McGregor's view, *ibid.*, para. 249, the duty to mitigate only arises if the plaintiff is claiming consequential damages and not where he is suing for ordinary market value arising out of a case of non-delivery, delayed delivery, or the delivery of defective goods.

<sup>292</sup>*R. Pagnan & Fratelli v. Corbisa Industrial Agropacuaria Limitada*, [1970] 1 W.L.R. 1306 (C.A.) did not involve a second purchase by the buyer from a new source, but the purchase of the same goods from the seller at a substantially reduced price after the buyer had initially rejected the goods. It was held that the second contract was part of a continuous course of dealing between the parties and not a wholly new and independent event. Consequently, in assessing the buyer's loss, the court brought into account the profit made by the buyer on the second purchase. As Professor Atiyah notes, footnote 171 *supra*, at p. 280, "While it is not wholly clear whether the result would have been the same if the second purchase had not been from the sellers the case does illustrate a modern reluctance to award damages for a 'loss' which in one sense is purely notional".

<sup>293</sup>See, for example, *Benjamin's Sale of Goods* (1974), para. 1277; *McGregor on Damages* (13th ed., 1972), para. 249; and compare, Atiyah, footnote 171 *supra*, pp. 279-80. Benjamin distinguishes between a resale by a *seller* following the buyer's failure to accept delivery and a covering purchase by the *buyer* following the seller's default. In the latter situation the learned authors would deny the seller the benefit of the buyer's lower actual damages, except in the situation as in the *Pagnan* case, footnote 292 *supra*, but they concede that in the former situation the seller's damages may be reduced if he resells promptly and had no other supplies in hand. The distinction is a difficult one.

<sup>294</sup>*Supra*, this ch., at p. 499.

<sup>295</sup>See, Draft Bill, s. 9.16(4).

*Co.*,<sup>296</sup> limits the aggrieved party to such damages as he has actually suffered without distinguishing between events occurring before or after the date of breach. We have adopted this position because, in our view, the criticism of the *Wertheim* case<sup>297</sup> confuses two separate issues. If the question is whether the aggrieved party should be entitled to recover enhanced damages because of loss of, or liability under, a sub-contract, the foreseeability of such damages is a relevant issue. But foreseeability has nothing to do with the question whether damages higher than those actually suffered should be recoverable. We agree with the Privy Council that the compensatory purpose of damages should be as applicable here as in other branches of contract law. Admittedly, this may lead to a lesser award than would otherwise be the case, but, in our view, this possibility is irrelevant. What is relevant is that the judgment leaves the aggrieved party in approximately the same position as if the contract had been performed, and this is what a damage award is supposed to do. We recognize that a market price test is easier to apply and that it has the appearance of being even-handed. However, its equitable nature disappears once it is conceded that the buyer's damages may be based on the results of a covering purchase. The question then becomes whether only post-breach factors may be taken into account, or whether the admissible evidence may also include antecedent events. For the reasons we have given we prefer the rule that is more generous to the seller. Accordingly, we recommend that the buyer should be limited to such damages as he has actually suffered without distinguishing between events occurring before or after the date of breach.

(e) IMPECUNIOSITY

In two comparatively recent Ontario cases, *R. G. McLean Ltd. v. Canadian Vickers Ltd.*<sup>298</sup> and *Freedhoff v. Pomalift Industries Ltd.*,<sup>299</sup> the question arose whether the buyer could claim aggravated damages, or could excuse his failure to mitigate, by reason of his impecuniosity. In both cases this argument was rejected with little hesitation on the ground of remoteness. It may be that these cases stand only for the proposition that the loss ascribable to the buyer's impecuniosity was not substantially foreseeable at the time of the making of the contract. On this reading the decisions were based on findings of fact, or mixed conclusions of law and

<sup>296</sup>[1911] A.C. 301 (P.C.), distinguished in *Williams Brothers v. Ed. T. Agius Ltd.*, [1914] A.C. 510 (H.L.).

<sup>297</sup>See, for example, *Benjamin's Sale of Goods* (1974), para. 1297, pp. 636-38. The principle enunciated in the *Wertheim* case has been applied or referred to approvingly in a substantial number of subsequent Canadian decisions although the facts of these cases often were very different from those in the *Wertheim* case. See, for example, *Sommerfeldt v. Petrovitch and Harnsey*, [1949] 4 D.L.R. 825 (Sask. C.A.); *Cotter v. General Petroleum Ltd. & Superior Oils Ltd.*, [1951] S.C.R. 154; *Dolly Varden Mines Ltd. v. Sunshine Exploration Ltd.* (1968), 69 D.L.R. (2d) 209 (B.C.C.A.); *Bezanson v. Kaintz* (1967), 61 D.L.R. (2d) 410 (N.S.S.C.); and *Asamera Oil Corporation Ltd. v. Sea Oil & General Corporation and Baud Corporation N.V.*, footnote 221 *supra*. The *Wertheim* case was distinguished in *Sharpe v. White* (1911), 25 O.L.R. 298 (C.A.). At p. 309, Meredith, J.A., reaffirmed the market price rule, though he admitted that it could lead to a windfall for the aggrieved party.

<sup>298</sup>[1971] 1 O.R. 207, (1970), 15 D.L.R. (3d) 15 (C.A.).

<sup>299</sup>[1971] 2 O.R. 773, (1971), 19 D.L.R. (3d) 153 (C.A.).

fact, and are of limited precedential value. If, however, the cases are considered to express a general proposition of law, they appear to be inconsistent with other authorities.<sup>300</sup> Thus, in *Trans Trust S.P.R.L. v. Danubian Trading Co. Ltd.*,<sup>301</sup> Denning, L.J., observed:<sup>302</sup>

It was also said that the damages were the result of the impecuniosity of the sellers and that it was a rule of law that such damages are too remote. I do not think there is any such rule. In the case of a breach of contract, it depends on whether the damages were reasonably foreseeable or not. In the present case they clearly were.

American law seems to adopt a similar position.<sup>303</sup>

So, once again, the road leads back to the construction and application of the rule in *Hadley v. Baxendale*, a task which, as we have suggested earlier, is best left to the courts. We do not think that the revised Act should contain an inventory of possible losses that will or may be regarded as foreseeable, or that are always to be deemed as non-recoverable because they are too remote. We see no virtue, and much danger, in this approach. Accordingly, we recommend that the revised Act should not attempt to regulate the circumstances in which a claim for enhanced damages based on the buyer's impecuniosity or inability to mitigate his damages may be recoverable.

#### (f) GOODS FOR USE: THE "REMA" PROBLEM

In our view, the value of leaving the rule in *Hadley v. Baxendale* to judicial development is admirably illustrated by the history of the problem that presented itself in *Cullinane v. British "Rema" Manufacturing Co. Ltd.*<sup>304</sup> As we interpret the majority judgments in that case, Evershed, M.R., and Jenkins, L.J., laid down the following proposition: that in the case of the loss of a profit-making machine the buyer can elect between recovering the capital value of the machine or suing for prospective loss of profits but that he cannot do both. It is now clear that this proposition cannot be taken at face value.

The elective principle is subject to the buyer's duty to mitigate<sup>305</sup> and, ordinarily, he will be expected to replace the machine once its unsuitability

<sup>300</sup>*Muhammad Issa el Sheik Ahmad v. Ali*, [1947] A.C. 414 (P.C.); *Trans Trust S.P.R.L. v. Danubian Trading Co. Ltd.*, [1952] 2 Q.B. 297 (C.A.). See, also, *Wroth v. Tyler*, [1974] Ch. 30, followed in *Metropolitan Trust Co. of Canada v. Pressure Concrete Services Ltd.*, [1973] 3 O.R. 629, (1973), 37 D.L.R. (3d) 649, affirmed (1975), 9 O.R. (2d) 375, 6 D.L.R. (3d) 431 (C.A.), with respect to the assessment of damages in equity and the relevance of the plaintiff's impecuniosity where a decree of specific performance is refused.

<sup>301</sup>[1952] 2 Q.B. 297 (C.A.).

<sup>302</sup>*Ibid.*, at p. 306. For a similar view see the judgment of Romer, L.J., at p. 307.

<sup>303</sup>McCormick, *Handbook on the Law of Damages* (1935), Rule 38, p. 140; and see, *Lake Village Implement Co. v. Cox* (1972), 478 S.W. 2d 36 (Ark. Sup. Ct.), especially at p. 42.

<sup>304</sup>[1954] 1 Q.B. 292 (C.A.).

<sup>305</sup>Street, *Principles of the Law of Damages* (1962), p. 245; *R. G. McLean Ltd. v. Canadian Vickers Ltd.*, footnote 298 *supra*; *Sunnyside Greenhouses Ltd. v. Golden West Seeds Ltd.* (1972), 27 D.L.R. (3d) 434 (Alta. S.C., App. Div.). See, also, Baer, "The Assessment of Damages for Breach of Contract — Loss of Profit" (1973), 51 Can. Bar Rev. 490.

ought to be clear. But since the defect, or its incurable nature, may not become obvious immediately, and since in any event replacement is bound to take some time, the buyer is entitled to claim for loss of profits during the interim period. Such claims, as recent decisions have indicated,<sup>306</sup> are not inconsistent with a concurrent claim for the return of the purchase price, provided that the profits are calculated on a net basis and make a fair allowance for the depreciation of the equipment during the period for which loss of profit is being claimed.

Further refinements of these rules can no doubt be expected. We do not believe that any statutory statement of the applicable principles would improve the position, or make it easier to solve particular problems. It could have the reverse effect. Accordingly, and subject to our earlier recommendation with respect to the formulation of the test of foreseeability of damages and the buyer's entitlement to claim consequential damages, we do not recommend that the revised Act should attempt to codify the common law principles either with respect to the measure of damages recoverable by the buyer where the goods bought are intended for use or with respect to his right to elect between recovery of his reliance and of his expectancy damages.

## E. RESTITUTIONARY REMEDIES

Where a buyer claims damages, he seeks compensation for the losses he has sustained as a result of the seller's breach of contract. Should, however, the buyer have conferred a benefit upon the seller in anticipation of the seller's performance of his contractual obligations, and should the seller default, the buyer may seek, by way of a restitutionary remedy, the return of this benefit.

Only one form of restitutionary remedy appears to be of particular significance from the buyer's point of view. This remedy is the buyer's right to recover payments made by him under the doctrine of total failure of consideration. His right to do so is expressly reserved in section 52 of the Ontario Sale of Goods Act. This section provides as follows:

52. Nothing in this Act affects the right of the buyer or the seller to recover interest or special damages in a case where by law interest or special damages may be recoverable, or to recover money paid where the consideration for the payment of it has failed.

The Code's counterpart of section 52 is UCC 2-711(1) which, *inter alia*, establishes and specifies the circumstances in which the buyer can recover so much of the price as has been paid. In practice the buyer is only likely to invoke the restitutionary remedy where he has no reliance or expectancy losses, or where the restitutionary award would be greater than such recoverable losses. The restitutionary remedy has, however, evidentiary advantages insofar as it saves the buyer the trouble of having to prove his actual damages.

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<sup>306</sup>*Ibid.* See, also, *T. C. Industrial Plant Pty Ltd. v. Robert's Queensland Pty. Ltd.*, [1964] A.L.R. 1083 (Aust. C.A.).

The question then arises under what circumstances should the restitutionary remedy be available? There is no difficulty in situations where the seller has never delivered the goods, or where the buyer has promptly rejected non-conforming goods. In both instances, in contemplation of law, the buyer has received no consideration for his payment. Under existing law,<sup>307</sup> however, any use or retention of the goods by the buyer, beyond the period reasonably necessary to determine their conformity, will be deemed to involve an acceptance. Once this event has occurred, it will be too late for the buyer to invoke his restitutionary remedy. It is true that under our previous recommendations the period of rejection may be substantially extended where the seller has encouraged the buyer to retain the goods while efforts are being made to cure the defect; but in principle this should not affect the buyer's restitutionary claim if, in law, he is deemed never to have accepted the goods.

Greater difficulties may be experienced if, as has been previously recommended, the revised Ontario Act incorporates a provision equivalent to UCC 2-608, with respect to the buyer's right to revoke his acceptance. American decisions under UCC 2-608, and under the preceding provisions in the *Uniform Sales Act*, show<sup>308</sup> that when a buyer revokes his acceptance and seeks the return of payments made he will be required to account for any benefits derived from the goods. If a similar approach were adopted by the Canadian courts it could mean that the buyer would lose his restitutionary remedy altogether. The reason is that an essential ingredient of the action for money had and received has frequently been said to be the absence of received benefits, other than benefits that are purely nominal: or, *quaere*, the ability to return any such benefits *in specie*.<sup>309</sup> American restitutionary theory has never been confined by this arbitrary rule, and apparently permits<sup>310</sup> the buyer to rescind the contract of sale and recover any payments made by him subject to a deduction in respect of benefits derived from the goods. We support this approach. Accordingly, we recommend that the revised Act should entitle the buyer to recover so much of the price as he has paid where the seller's conduct amounts to a substantial breach and the seller repudiates, fails to make delivery or to perform an act due before delivery, or where the buyer rightfully rejects or revokes acceptance.<sup>311</sup> We further recommend that where the buyer has received the goods any claim by a buyer to recover so much of the price

<sup>307</sup>*Supra*, this ch., sec. C.1(a)(ii).

<sup>308</sup>For example, *Orange Motors of Coral Gables Inc. v. Dade County Dairies Inc.* (1972), 258 So. 2d 319 (Fla. Ct. App.); *Balon v. Hotel & Restaurant Supplies Inc.* (1967), 433 P. 2d 661 (Ariz. Ct. App.).

<sup>309</sup>*Hunt v. Silk*, [1803-13] All E.R. Rep. 655; Treitel, *The Law of Contract* (4th ed., 1975), at pp. 698-99; Goff and Jones, *The Law of Restitution* (2nd ed., 1978), pp. 372 *et seq.* Goff and Jones, at p. 374, take the position that benefits, if in the form of enjoyment of goods or land, must be of a "reasonably substantial nature to defeat such a claim [in quasi-contract]"; but see, *contra*, *The Canadian Encyclopedic Digest (Ontario)* (3rd ed., 1974), Vol. 5, p. 32-309, para. 562 and cases noted therein.

<sup>310</sup>*Restatement of the Law of Restitution* (1937), secs. 144, 159, and *Restatement of the Law of Contracts* (1932), secs. 347-54, 356.

<sup>311</sup>See, Draft Bill, s. 9.12(2)3. Section 9.12(2)3 has its counterpart in UCC 2-711(1). It will be observed that the buyer's right to reject is subject to the provisions on the seller's right to cure.

as has been paid should be subject to such a reduction on account of any benefits derived by him from the use or possession of the goods as is just in the circumstances.<sup>312</sup>

Adoption of this solution may not, of itself, resolve the conundrum posed by *Rowland v. Divall*<sup>313</sup> which has so troubled some English commentators.<sup>314</sup> The problem is this. If it transpires that the seller never had title to the goods that he purported to deliver in fulfillment of his contract of sale, or that his title was defective in some other respect, should the buyer be accountable for the use he has derived from the goods? It is sometimes assumed that this question only arises in the context of a buyer's claim for the return of the purchase price, but this does not appear to be correct. The same question arises if the buyer claims damages for breach of the condition of title, assuming he has rescinded the contract or that the goods have been taken from him by their true owner.

In *Rowland v. Divall*, mentioned above, the plaintiff-buyer had, in good faith, purchased a motor vehicle from the defendant-seller. It transpired that the motor vehicle had been stolen and that the defendant did not have a good title. The car was taken by the police and the buyer brought an action to recover the purchase price he had paid on the ground of total failure of consideration. All members of the Court<sup>315</sup> were agreed that the buyer had derived no benefits under the contract of sale that would defeat his restitutionary claim. He obviously had not received the title and, equally obviously, he had not obtained lawful possession. It was true that he had had the use of the car for several months but, as the judgments observed,<sup>316</sup> it was not a lawful use. It is, therefore, difficult to see how the decision could have been different unless it is argued that the lawfulness or unlawfulness of the derived benefits is immaterial for the purpose of adjusting restitutionary claims. An example has been given of a buyer who purchases a crate of whisky that turns out to be stolen. In the meantime the buyer has consumed the liquor. It has been argued that it would be unjust that the buyer should be able to avoid paying the price,

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<sup>312</sup>See, Draft Bill, s. 9.14. Section 9.14 has no express counterpart in the Code but the principles of law and equity are preserved in UCC 1-103. A precedent for s. 9.14 is to be found in the 1977 draft UNCITRAL Convention, Article 55 of which provides:

- (1) If the seller is bound to refund the price, he must also pay interest thereon from the date on which the price was paid.
- (2) The buyer must account to the seller for all benefits which he has derived from the goods or part of them:
  - (a) if he must make restitution of the goods or part of them; or
  - (b) if it is impossible for him to make restitution of all or part of the goods or to make restitution of all or part of the goods substantially in the condition in which he received them, but he has nevertheless declared the contract avoided or required the seller to deliver substitute goods.

<sup>313</sup>[1923] 2 K.B. 500 (C.A.).

<sup>314</sup>See, for example, Atiyah, *The Sale of Goods* (5th ed., 1975), pp. 51-52; and Treitel, "Some Problems of Breach of Contract" (1967), 30 Mod. L. Rev. 139, at pp. 146-49.

<sup>315</sup>Bankes, Scrutton, and Atkin, L.JJ.

<sup>316</sup>[1923] 2 K.B. 500 (C.A.) *per* Bankes, L.J., at p. 504, and *per* Atkin, L.J., at p. 506.

or be entitled to recover the price if it has already been paid; but, as has been pointed out, much will depend on what the true owner decides to do.<sup>317</sup> If he elects to sue the seller in conversion and the seller pays him, the buyer's position looks weak. If it is the buyer who has been sued, or is being threatened with suit by the true owner, it is difficult to see why he should not be entitled to be fully indemnified by the seller; although, presumably, he cannot claim both an indemnity *and* the refund of the payments made by him. The difficulties will be most acute where the true owner has not yet determined whom he will sue, or where the identity of the true owner is unknown. However, there is much to be said for the argument accepted by Finnemore, J., in *Warman v. Southern Counties Car Finance Corp. Ltd.*<sup>318</sup> that the buyer should not have to wait to be sued before being entitled to exercise his rescissionary remedy. Alternatively, he should at least be entitled to demand that the seller cure the defect in his title.

Leaving aside these difficulties, and assuming that the buyer has received some benefit from the use of the goods, there is still the difficult question of valuing the benefit. In the *Warman* case, Finnemore, J., rejected the contention<sup>319</sup> that the hirer who had agreed "to rent" a car under a hire-purchase agreement should be subject to a set-off in respect of the rental value of the car while it was in his possession. Finnemore, J., observed that if the hirer had simply wanted to rent a car he would have done so. Similar difficulties arise<sup>320</sup> if other criteria are adopted such as depreciation or profits made through the use of the goods.

These problems have been the subject of study and recommendations both in the New South Wales Working Paper<sup>321</sup> and in a Working Paper on *Pecuniary Restitution on Breach of Contract*<sup>322</sup> published by the English Law Commission in 1975. The New South Wales Working Paper made two recommendations: first, that the seller should be given a reasonable time to perfect his title before the buyer can rescind for breach of warranty of title; and, secondly, that if the seller fails to perfect his title within a reasonable time, the buyer should be entitled to claim a refund of the purchase price. However, it would be a condition of the buyer's right to recovery that he join the true owner as a party to the action, and that he offer to pay the true owner reasonable compensation for his use and enjoyment of the goods. The buyer should also have the alternative remedy of damages. The English Working Paper offered the following provisional recommendations:<sup>323</sup>

- (a) If he has conferred a valuable benefit on the buyer by the delivery of possession of the goods, the seller should be entitled

<sup>317</sup>Atiyah, *The Sale of Goods* (4th ed., 1971), p. 46; and Atiyah, *The Sale of Goods* (5th ed., 1975), pp. 51-52.

<sup>318</sup>[1949] 2 K.B. 576. This case involved a hire-purchase agreement.

<sup>319</sup>*Ibid.*, at pp. 581-82.

<sup>320</sup>Treitel, "Some Problems of Breach of Contract" (1967), 30 Mod. L. Rev. 139, at pp. 146-49.

<sup>321</sup>*Supra*, footnote 240, Summary of Recommendations, paras. 15.66, 15.67.

<sup>322</sup>Law Com. Working Paper No. 65, *Pecuniary Restitution on Breach of Contract* (1975).

<sup>323</sup>*Ibid.*, pp. 66-67.

to be paid (or as the case may [*sic*], to retain) the value of the benefit so conferred.

- (b) The seller should be regarded as having conferred a valuable benefit on the buyer for the purposes of (a) where — but only where — a suitable replacement for the goods delivered may reasonably be obtained by the buyer at less than the original contract price, in which event the value of the benefit should be the difference between the original contract price and the price of the replacement *or* the amount by which the market price of the goods in question has fallen during the period of the buyer's possession, whichever may be the less.
- (c) The seller's entitlement under (a) should be conditional upon the satisfaction of the true owner's claims against the buyer.
- (d) Proposal (a) should not apply where the seller has sold stolen goods knowing or believing them to be stolen.

We do not find either set of recommendations completely satisfactory. We support the New South Wales recommendation that the seller should have an opportunity to cure the defect in title because it is consistent with the seller's general right to cure that we have recommended for adoption earlier in this chapter. However, in our opinion there is no justification for imposing on the buyer, if he seeks to recover the purchase price from the seller, the onus of joining the owner as a third party. We find two difficulties with the English proposals for measuring the value of the benefits conferred on the buyer: first, they are too rigid and, secondly, for obvious reasons, they do not concern themselves with the valuation of benefits where the buyer revokes his acceptance. In all cases we would prefer to leave the assessment of benefits to the discretion of the court, and not to draw a distinction between different types of restitutionary claim.

In our opinion, restitutionary claims for defects in title should be put on the same footing as claims arising out of other defects that entitle the buyer to claim the return of the price. We have previously recommended that where the buyer has received the goods any claim by a buyer to recover so much of the price as has been paid should be subject to such a reduction on account of any benefits derived by him from the use or possession of the goods as is just in the circumstances. In our view this recommendation should also apply to a buyer's claim to recover the purchase price where there is a defect in the seller's title and we so recommend. In addition, following our earlier recommendations the seller will have an opportunity to cure the defect in title if he satisfies the requirements generally applicable to a seller's right to cure a non-conforming tender or delivery.

We would anticipate that, to the extent that the seller is given an opportunity to cure the defect in his title, and exercises it, the need for the court to exercise its discretion in quantifying the benefits conferred upon the buyer will be greatly diminished in practice. To a lesser extent this will also be true in other cases where the seller has a right to cure other forms of defective performance. On the other hand, where the court

is called upon to exercise its discretion in quantifying the benefits conferred, there is no reason why it may not take into consideration the good faith of each of the parties. It should, however, be clearly understood that the buyer is not obliged to pursue his restitutionary remedy and that, as under existing law, he should continue to have the option of suing for damages. We so recommend.<sup>324</sup>

### RECOMMENDATIONS

The Commission makes the following recommendations:

1. The revised Act should contain an index section of buyer's remedies. This section should distinguish between the buyer's remedies for substantial and non-substantial breach of a contract of sale.
2. With respect to the buyer's right to obtain an order for specific performance:

- \*(a) The provision in the revised Act comparable to section 50 of the existing Sale of Goods Act dealing with specific performance should not be confined to contracts for the delivery of "specific or ascertained goods", but should read as follows:

In an action against the seller for breach of contract to deliver promised goods, whether or not the goods existed or were identified at the time of the contract, the court may direct that the contract be performed specifically and may impose such terms and conditions as to damages, payment of the price, and otherwise, as seem just to the court.

- (b) No attempt should be made in the revised Sales Act to resolve an apparent conflict between the buyer's right to compel delivery of goods under *The Replevin Act* and the discretionary remedy of specific performance under *The Sale of Goods Act*. Any change in the Ontario Replevin Act, as applicable to contracts of sale, should form part of a comprehensive review of replevin law.
- (c) The revised Act should not adopt a provision equivalent to UCC 2-502 dealing with the buyer's right to recover goods from an insolvent seller; rather, this issue should be resolved within the context of the law of bankruptcy. Consideration should also be given to a review of *The Personal Property Security Act* by the Advisory Committee on that Act, with a view to determining whether *The Personal Property Security Act* should be amended to accommodate more adequately the security needs of buyers.

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<sup>324</sup>See, Draft Bill, s. 9.12(2).

\*The Honourable J. C. McRuer dissents from this recommendation. See, footnote 50, *supra*.

3. The buyer's right to reject a non-conforming tender under the revised Act should, in the absence of contrary agreement, be confined to cases where the non-conformity amounts to a substantial breach of the seller's obligations.
4. The buyer's right to reject should not turn, as is the case under section 12(3) of the existing Sale of Goods Act, on whether, in a non-severable contract, the buyer has accepted part of the goods, or on whether the contract involves a sale of specific or non-specific goods or title has passed to the buyer. Accordingly,
  - (a) (i) the buyer should not lose his right to reject where he has accepted part of a non-severable consignment of goods; rather, the revised Act should provide that, where the non-conformity amounts to a substantial breach, the buyer may accept the whole, reject the whole, or accept one or more commercial units and reject the rest;
  - (ii) in the light of the above recommendation, section 29 of the existing Act should be omitted from the revised Act;
  - (b) the buyer should not lose his right to reject where the contract involves a sale of specific goods the property in which has passed to the buyer;
  - (c) section 12(3) of the existing Sale of Goods Act should be omitted from the revised Sales Act.
5. Subject to recommendations 6-11, *infra*, the revised Act should confer upon the seller a right to cure a non-conforming tender or delivery where the buyer has rightfully rejected or revoked his acceptance of the goods.
6. The seller's right to cure should be subject to the following safeguards:
  - (a) the seller must seasonably notify the buyer of his intention to cure the non-conformity following the buyer's rejection;
  - (b) the non-conformity must be capable of cure without unreasonable prejudice, risk or inconvenience to the buyer; and
  - (c) the type of cure offered by the seller must be reasonable in the circumstances.
7. (a) The seller's right to cure under the revised Act should arise,
  - (i) subject to recommendation (b)(i), *infra*, where the buyer rightfully rejects a non-conforming tender or

- delivery, whether before or after the time for performance has expired; and
  - (ii) where the buyer revokes his acceptance of the goods.
- (b) The seller should not have a right to cure,
- (i) in the case of a late tender or delivery amounting to a substantial breach; or
  - (ii) where the seller fails to cure in response to a demand by the buyer, and the buyer accordingly exercises his right to reject.
8. Subject to recommendation No. 7(b)(i), *supra*, the revised Act should not restrict the type of non-conforming tender that may be the subject of cure.
9. The revised Act should specify the permissible types of cure that are available to the seller. For the purpose of the cure provisions in the revised Act, "cure" should mean,
- (a) tender or delivery of any missing part or quantity of the goods;
  - (b) tender or delivery of other goods or documents which are in conformity with the contract;
  - (c) the remedying of any other defect, including a defect in title; or
- \*\*(d) a money allowance or other form of adjustment of the terms of the contract.
10. Where the seller elects to cure a non-conformity, the buyer should be entitled to suspend performance of his obligations until the non-conformity has been cured.
11. The seller's election to cure should not affect the buyer's right to recover damages in respect of the non-conformity.
- \*\*\*12. Whether or not the non-conformity is such as to entitle the buyer to reject the tender or delivery, the buyer should be able, subject to recommendation No. 13, *infra*, to require the non-conformity to be cured within a reasonable time. If the seller fails to cure a non-conformity in response to the buyer's demand, the buyer should be entitled to reject the tender or delivery and to exercise the same remedies as if the non-conformity had amounted to a substantial breach of the seller's obligations.
13. The buyer's right to demand cure should be subject to the same safeguards as are recommended, *supra*, in respect of the seller's right to cure.

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\*\*The Honourable J. C. McRuer dissents from this recommendation. See, footnote 146, *supra*.

\*\*\*The Honourable G. A. Gale and the Honourable J. C. McRuer dissent from this recommendation. See, footnote 150, *supra*.

14. The definition of cure recommended in respect of the seller's right to cure should apply to the buyer's right to demand cure.
15. Where, in the case of a substantial breach, the buyer demands cure, he should be able to suspend performance of his obligations until the non-conformity has been cured; where, however, the non-conformity is non-substantial but the buyer nevertheless demands cure, the buyer should not be able to suspend performance of his obligations pending cure by the seller.
16. The revised Act should contain a separate provision governing the buyer's right to demand cure in the case of a late tender or delivery. This provision should be to the effect that, where the seller fails to tender or deliver the goods or document of title on the date or within the time provided in the contract, the buyer may fix a further reasonable period for the performance of either of such obligations and, if the seller's failure is not cured within the further period, the buyer may treat the breach as a substantial breach.
17. With respect to the buyer's right to examine the goods, the revised Act should adopt, in place of section 33 of the existing Sale of Goods Act, a provision similar to UCC 2-513(1) to the effect that, unless otherwise agreed and except in the case of documentary sales and delivery on C.O.D. or similar terms, the buyer is entitled before payment or acceptance of the goods to inspect them at any reasonable place and time and in any reasonable manner.
18. The revised Act should adopt, in place of section 34 of the existing Sale of Goods Act, provisions similar to UCC 2-606(1)(a) and (b) and UCC 2-606(2) dealing with the buyer's acceptance of the goods. The inconsistent act rule contained in section 34, and in UCC 2-606(1)(c), should be replaced by a provision to the effect that the buyer will be deemed to have accepted the goods where the goods are no longer in substantially the condition in which the buyer received them except where the change in the condition of the goods was caused by their own defects or by casualty suffered by the goods while they were at the seller's risk.
19. The revised Act should adopt a provision that is similar to, but more flexible than, UCC 2-602(2)(a) dealing with the effect, after rejection of the goods, of any exercise of ownership by the buyer. This provision should read as follows:
 

after rejection, use of the goods or other acts of ownership by the buyer are *prima facie* wrongful as against the seller but do not nullify the rejection unless the seller has been materially prejudiced thereby.
20. Subject to recommendation No. 21, *infra*, a provision comparable to UCC 2-608 dealing with the buyer's right to revoke

acceptance in whole or in part should be incorporated in the revised Act.

21. The provision in the revised Act comparable to UCC 2-608 should not contain the subjective test of substantial impairment imported by the words in UCC 2-608(1), "substantially impairs its value *to him*", but should provide that the buyer may revoke his acceptance of a lot or commercial unit whose non-conformity "amounts to a substantial breach".
22. With respect to the buyer's powers and duties in respect of goods in the buyer's possession that he has rejected, the revised Act should incorporate:
  - (a) a provision comparable to UCC 2-602(2)(b) obliging the buyer, after rejection, to hold the goods with reasonable care at the seller's disposition for a time sufficient to permit the seller to remove the goods;
  - (b) provisions comparable to UCC 2-604 dealing with the buyer's options as to salvage of rejected goods;
  - (c) provisions comparable to UCC 2-603 dealing with a merchant buyer's duties with respect to rejected goods; and
  - (d) in addition to provisions comparable to UCC 2-603(3) requiring the buyer to act in good faith and with reasonable care, a provision to the effect that, where the parties do not agree as to the buyer's right to reject the goods, any instructions given to, or action taken by, the buyer pursuant to the provision in the revised Act comparable to UCC 2-603(1), do not affect any other rights of the parties.
23. The revised Act should incorporate provisions comparable to UCC 2-605(1)(a) and UCC 2-605(2) dealing with the effect of the buyer's failure to state his grounds of rejection. A provision comparable to UCC 2-605(1)(b) should not be incorporated in the revised Act.
24. A provision comparable to UCC 2-607(3)(a) requiring a buyer, after acceptance of the goods, to give the seller notice of any breach within a reasonable time after he discovers or should have discovered the breach, should not be incorporated in the revised Act, either for consumer buyers or for merchant buyers. Nor should the revised Act adopt provisions comparable to UCC 2-607(3)(b) requiring the buyer, in the case of infringement or the like, to notify the seller of suit by a third party, or the related provision in UCC 2-607(5)(b).
25. The revised Act should not incorporate the vouching-in procedure in UCC 2-607(5)(a).

26. A provision comparable to UCC 2-711(3) conferring upon a buyer who rightfully rejects or justifiably revokes acceptance of goods, a security interest in respect of goods in his possession or control for any payments made on their price and any reasonable expenses incurred by him in their inspection, receipt, transportation, care and custody, should be incorporated in the revised Act.
27. The provisions in the revised Act corresponding to UCC 2-602, UCC 2-603, UCC 2-604 and UCC 2-605 should also apply to goods wrongfully, but effectively, rejected by the buyer.
- \*\*\*\*28. The question whether a distinction should be drawn between the measure of damages applicable in claims against a non-merchant seller and those applicable in claims against a merchant seller should be referred for further study to the Law of Contract Amendment Project.
29. The seller and buyer should continue to be liable under the revised Act for all substantially foreseeable damages arising from a breach and falling within the *Hadley v. Baxendale* formula as refined in the decision in *The Heron II*. Accordingly,
  - (a) the test of foreseeability in sections 49(2) and 51(2) in respect of the buyer's claim for damages in the existing Sale of Goods Act should be reformulated in the revised Act to read as follows:
 

The measure of damages is the estimated loss which, having regard to the seller's knowledge of all the circumstances, he ought to have foreseen as likely to result from his breach of contract.
  - (b) Likewise, with respect to the damage claims of the seller for breach by the buyer, the revised Act should contain a comparable reformulation of section 48(2) of the present Act.
30. Section 51 should be expanded in the revised Act to cover all claims for non-conforming tenders involving accepted goods and should also incorporate the best features of UCC 2-714.
31. The seller's or buyer's right to claim consequential damages should be stated in more affirmative language, as is done in UCC 2-715(2). The revised Act should incorporate a single provision, in place of section 52 of the existing Act, in respect of incidental and consequential damages, and in preference to UCC 2-715(1) and 2(a). This section should read as follows:

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\*\*\*\*The Honourable G. A. Gale dissents from this recommendation. See, footnote 242, *supra*.

A seller's or buyer's claim for damages may include a claim for incidental or consequential damages.

32. The revised Act should make it clear, as does UCC 2-715(2) (b), that where injury to person or property is alleged, it is sufficient to show that the injury resulted proximately from breach of warranty.
33. A provision corresponding to UCC 2-712(1) should be adopted in the revised Act permitting the buyer to cover his loss by making in good faith and without any unreasonable delay any reasonable purchase of or contract to purchase goods in substitution for those due from the seller where the seller's conduct amounts to a substantial breach and the seller repudiates, fails to make delivery or to perform an act due before delivery, or where the buyer rightfully rejects or revokes acceptance.
34. Where the buyer has elected to cover, he should, as in UCC 2-712(2), be entitled to recover as damages the difference between the cost of cover and the contract price less expenses, if any, saved in consequence of the seller's breach, but failure to cover should not bar the buyer from any other remedy.
35. A buyer who elects to cover should be bound by the results of his election in claiming his damages. The recommended general provision in the revised Act dealing with the computation and measure of the buyer's damages should state that the buyer is not entitled to sue for the difference between the contract price and the price recommended in chapter 18, *infra*, for adoption in lieu of the market price, if his actual loss is less than this difference.
36. The revised Act should not attempt to specify the circumstances in which the buyer may be entitled to recover enhanced damages on the ground that the seller's failure to perform has caused him to lose a profitable sub-contract or on the ground that the seller's breach has involved him in damage claims brought by his sub-buyer.
37. The buyer should be limited to such damages as he has actually suffered without distinguishing between events occurring before or after the date of breach.
38. The revised Act should not attempt to regulate the circumstances in which a claim for enhanced damages based on the buyer's impecuniosity or inability to mitigate his damages may be recoverable.
39. Subject to recommendations 29, 31 and 32, *supra*, the revised Act should not attempt to codify the common law principles either with respect to the measure of damages recoverable by the buyer where the goods bought are intended for use or with

respect to his right to elect between recovery of his reliance and expectancy damages.

40. (a) The revised Act should entitle the buyer to recover so much of the price as has been paid, where the seller's conduct amounts to a substantial breach and the seller repudiates, fails to make delivery or to perform an act due before delivery, or where the buyer rightfully rejects or revokes acceptance.  
  
(b) Where the buyer has received the goods any claim by a buyer to recover so much of the price as has been paid should be subject to such a reduction on account of any benefits derived by him from the use or possession of the goods as is just in the circumstances.
41. Recommendation No. 40 should apply to a buyer's claim to recover the purchase price where there is a defect in the seller's title. The seller should also have an opportunity to cure defects in title as an aspect of the seller's general right to cure, discussed in recommendations 5-11, *supra*.
42. The revised Act should make clear that the buyer is not obliged to pursue his restitutionary remedy and that, as under existing law, he should continue to have the option of suing for damages.

## CHAPTER 18

### ISSUES COMMON TO SELLER'S AND BUYER'S REMEDIES

In chapter 16 of this Report, we discussed the seller's remedies for breach of a contract of sale by the buyer. Chapter 17 was concerned with the buyer's remedies for breach by the seller. In this chapter, we deal with issues common to both buyer's and seller's remedies.

#### 1. MEANING OF "SUBSTANTIAL BREACH"

As will have been apparent from chapters 16 and 17, the concept of substantial breach is fundamental to the proposed remedial provisions of the revised Ontario Sale of Goods Act. It will determine, for example, the circumstances in which an aggrieved seller or buyer will be entitled to cancel the contract,<sup>1</sup> and it will determine the buyer's right to reject a non-conforming tender.<sup>2</sup> The concept of substantial breach will also, as explained in a later section of this chapter, govern the consequences of an anticipatory repudiation and the parties' rights under an instalment contract.<sup>3</sup> We turn now to consider a number of issues arising out of the adoption of a test of "substantial breach".

##### (a) TERMINOLOGY

The Saskatchewan Consumer Products Warranties Act, 1977<sup>4</sup> provides a precedent for use of the term "substantial breach". A similar concept appears in sections 2-610 and 2-612<sup>5</sup> of the *Uniform Commercial Code*, which speak in terms of a substantial impairment of value. There is, however, nothing sacrosanct about the term "substantial breach", and other expressions, such as "material breach", "major breach"<sup>6</sup> or "serious breach" would convey the same flavour. For a number of reasons, we have consciously eschewed adoption of the term "fundamental breach", which appears both in Article 10 of the Uniform Law on the International Sale of Goods (ULIS) and in Article 8 of the 1977 draft UNCITRAL Convention. The first reason is that, in Anglo-Canadian jurisprudence, the term has become too closely associated with disclaimer and exception clauses to be readily adaptable to a broader purpose without causing confusion. Secondly, the normal test of a fundamental breach — that is, a breach that "goes to the root" or that destroys the "basis" or "founda-

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<sup>1</sup>See, Draft Bill, ss. 9.3(2)1, 9.12(2)2.

<sup>2</sup>See, Draft Bill, s. 8.1(a).

<sup>3</sup>See, *infra*, this ch., secs. 4 and 5; and see, also, Draft Bill, ss. 8.10, 8.12.

<sup>4</sup>S.S. 1976-77, c. 15, ss. 2(c), 20. The Saskatchewan Act refers to a "breach of a substantial character".

<sup>5</sup>Dealing, respectively, with anticipatory repudiation and breach of an instalment contract.

<sup>6</sup>Compare, the *Consumer Product Warranty and Liability Act*, S.N.B. 1978, c. C-18.1, s. 14(1)(b); *Restatement of the Law, Contracts 2d, Tent. Draft No. 8*, secs. 262-63, 266.

tion" of the agreement — is, in our view, too stringent a test to govern an aggrieved party's right to cancel the contract or to reject a non-conforming tender.<sup>7</sup> We think it should be sufficient if the aggrieved party has been prejudiced by the breach to such a degree that it would be unreasonable to require him to continue with the contract and to confine himself to a claim in damages. He should not have to show that the breach has totally undermined the value of the bargain. Finally, the ULIS and UNCITRAL terminology is misleading. The term "fundamental breach" is not confined in ULIS to breaches that totally undermine the value of the bargain, and is equated in the UNCITRAL test with "substantial detriment".

(b) DEFINITION

Having adopted the concept of "substantial breach", the question arises whether the term should be defined. It may be argued that a definition is not needed at all, and that it would be better to leave the expression undefined, as is done in other branches of contract law that adopt a concept of substantial breach. On balance, however, we favour the adoption of a modest definition, designed to give our courts the benefit of American jurisprudence on the Code's test of substantial impairment of value. Accordingly, we recommend that the revised Act adopt the following definition of "substantial breach":<sup>8</sup>

'substantial breach' means a breach of contract that the party in breach foresaw or ought reasonably to have foreseen as likely to impair substantially the value of the contract to the other party.

We have not copied Article 10 of ULIS because of the strong and, in our view justified, criticisms to which its complex provisions have been exposed.<sup>9</sup> On the other hand, our definition has close affinities with the definition of fundamental breach in Article 8 of the 1977 draft UNCITRAL Convention, which reads as follows:

8. A breach committed by one of the parties is fundamental if it results in substantial detriment to the other party unless the party in breach did not foresee and had no reason to foresee such a result.

In our view, the test of substantial detriment contained in Article 8, and that of substantial impairment of value contained in our recommended definition of substantial breach, may be regarded as synonymous terms: it is difficult to conceive of a substantial detriment that will not also result in a substantial impairment of the value of the contract to the other party. We have borrowed from Article 8 the requirement of reasonable foreseeability, because it is consistent with the *Hadley v. Baxendale* formula for the recovery of damages that we have recommended, in chapter 17, for adoption in the revised Ontario Act. It would be anomalous, we think, to

<sup>7</sup>Compare, Treitel, *The Law of Contract* (4th ed., 1975), at pp. 543 *et seq.*, and *Decro-Wall International S.A. v. Practitioners in Marketing Ltd.*, [1971] 1 W.L.R. 361 (C.A.), 380.

<sup>8</sup>See, Draft Bill, s. 1.1(1)24.

<sup>9</sup>See, *supra*, ch. 2, sec. 5(a); and see, also, Graveson, Cohn & Graveson, *The Uniform Laws on International Sales Act 1967* (1968), at pp. 55 *et seq.*

apply different tests of foreseeability in the two types of case, or to dispense with a test of foreseeability altogether where a substantial breach of contract is alleged.

Two possible objections to our definition of substantial breach may be noted. One is that it does not carry the reader very far: it is the beginning, not the end of the inquiry.<sup>10</sup> We recognize that it would be possible to adopt a much more comprehensive series of tests, along the lines, perhaps, of section 275 of the *Restatement of the Law of Contracts*, or section 266 of the *Second Restatement on Contracts*.<sup>11</sup> We have not, however, chosen this route because, in our view, access to the Code's jurisprudence on the meaning of substantial impairment of value will be more helpful. Secondly, it may be objected that our definition considers the impact of the breach exclusively from the aggrieved party's point of view, and that it fails to take into consideration the hardship to the guilty party in permitting cancellation of the contract. The answer to this objection is two-fold. In the first place, the right to cure that we have previously recommended<sup>12</sup> is designed to mitigate such hardship. Secondly, sales law has traditionally judged a breach in terms of its actual or assumed impact on the aggrieved party. We do not, therefore, consider that there is any substance to these objections.

#### (c) SINGLE OR MULTIPLE TESTS?

We recognize that the test of substantial breach will have to be applied in a great variety of circumstances, and that whether a breach of contract will amount to a substantial breach in a given case will depend on the inferences to be drawn from all the facts. We have concluded that a single test of substantial breach, applied flexibly, is to be preferred to a series of diverse tests to be applied in different contexts. This is the approach adopted in Article 2 of the *Uniform Commercial Code*, in ULIS, and in the 1977 draft UNCITRAL Convention, and we recommend its adoption in the revised Act.<sup>13</sup>

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<sup>10</sup>Compare, White & Summers, *Handbook of the Law Under the Uniform Commercial Code* (1972), at pp. 257-58.

<sup>11</sup>Section 266 of the *Restatement of the Law, Contracts 2d*, provides:

In determining whether a failure to perform or to make an offer to perform is material, the following circumstances are significant:

- (a) the extent to which the injured party will be deprived of the benefit which he reasonably expected;
- (b) the extent to which the injured party can be adequately compensated for the part of that benefit of which he will be deprived;
- (c) the extent to which the party failing to perform or to offer to perform will suffer forfeiture;
- (d) the likelihood that the party failing to perform or to offer to perform will cure his failure, taking account of all the circumstances including any reasonable assurances;
- (e) the extent to which the behaviour of the party failing to perform or to offer to perform comports with standards of good faith and fair dealing.

<sup>12</sup>*Supra*, ch. 17, sec. C.1(d)(ii)(1).

<sup>13</sup>See, Draft Bill, s. 1.1(1)24.

## (d) REPUDIATION AND BREACH

A learned author has recently argued<sup>14</sup> that there is a distinction between a breach going to the root of a contract and repudiation<sup>15</sup> of a contract. This difference is said to exist even where, apparently, the repudiation, like a performance breach, occurs at the time performance falls due. The two concepts, it is maintained, frequently overlap, but are not the same. We are not persuaded that this distinction is meaningful.<sup>16</sup> However, whether or not we are correct in this position, it should be clearly understood that our definition of substantial breach is intended to embrace acts or conduct amounting to a repudiation of a contract at the time when performance is due, as well as other breaches. That this is our intention should be evident from a reading of the section<sup>17</sup> of the Draft Bill dealing with repudiation of a future performance "the loss of which would amount to a substantial breach of the contract", and the section<sup>18</sup> dealing with the circumstances in which, in an instalment contract, breach with respect to one or more instalments may be treated as a substantial breach of the whole contract.

It may be argued, however, that these two provisions do not cover a situation where breach of a present obligation, which does not of itself amount to a substantial breach, is accompanied by repudiatory language with respect to a basic obligation.<sup>19</sup> Such a situation might be dealt with in two ways. First, it might be said that the quality of the breach must be judged in its total setting. This is the approach adopted in subsection (2) of section 268 of the *Second Restatement on Contracts*, which provides as follows:

268.(2) Except as stated in subsection (3), a breach by non-performance accompanied or followed by a repudiation gives rise to a claim for damages for total breach.

Alternatively, the repudiatory element might be severed and dealt with in accordance with the normal rules governing anticipatory breach.<sup>20</sup> Although we have not thought it necessary to address this point specifically in our definition of "substantial breach", we would emphasize that acts or con-

<sup>14</sup>McRae, "Repudiation of Contracts in Canadian Law" (1978), 56 Can. Bar Rev. 233, at pp. 238-41.

<sup>15</sup>Repudiation occurs where a party's acts or conduct amount "to an intimation of an intention to abandon and altogether to refuse performance of the contract": *Freeth v. Burr* (1874), 9 L.R.C.P. 208, 213, cited in McRae, footnote 14 *supra*, at p. 234.

<sup>16</sup>As Professor McRae himself notes, footnote 14 *supra*, at p. 241, section 17(2) of the British Columbia *Sale of Goods Act* (which is the same as s. 12(2) of the Ontario Act) also treats the two concepts as interchangeable (wrongly in his view) where it refers to a condition as a term "the breach of which may give rise to a right to treat the contract as repudiated".

<sup>17</sup>Section 8.10(1).

<sup>18</sup>Section 8.12(3).

<sup>19</sup>As, for example, where a buyer whose payments are in arrears advises the seller that his financial position will not allow him to pay. Compare, *Bridge v. Campbell Discount Co. Ltd.*, [1962] A.C. 600 (H.L.).

<sup>20</sup>Compare, *Restatement of the Law, Contracts 2d*, s. 278, Comment a.

duct amounting to a repudiation at the time when performance is due are intended to constitute a substantial breach within the meaning of our definition of the term.

## 2. THE MARKET PRICE TEST

Since the early part of the 19th century, the common law courts have applied a market price test to determine the *prima facie* damages suffered by a seller confronted with a defaulting buyer, or by a buyer faced with a non-performing seller. There is obviously much to commend this test. In optimum conditions it provides a ready yardstick for the quantification of damages, and at the same time it reaffirms the innocent party's obligation to mitigate his damages by taking those steps that a reasonably prudent person would take in his place. The market price test reappears in sections 48(3) and 49(3) of *The Sale of Goods Act*,<sup>21</sup> and is also adopted in Article 2 of the *Uniform Commercial Code*.<sup>22</sup> Nevertheless, despite its respectable age, a number of important aspects of the market price test remain shrouded in uncertainty.

### (a) MEASURE OF DAMAGES: "AVAILABLE MARKET" OR "COMMERCIALLY REASONABLE PURCHASE OR DISPOSITION"

As the opening words to sections 48(3) and 49(3) of *The Sale of Goods Act* indicate, the market price test is premised on the existence of an available market. There is, however, considerable uncertainty about the meaning of "available market". In *Dunkirk Colliery Co. v. Lever*,<sup>23</sup> James, L.J., enunciated the following test:

. . . when the defendant refused to take the 300 tons the first week or the first month, the plaintiffs might have sent it in wagons somewhere else, where they could sell it, just as they sell corn on the Exchange, or cotton at Liverpool: that is to say, that there was a fair market where they could have found a purchaser either by themselves or through some agent at some particular place.

James, L.J., therefore, postulated some fixed geographical location where buyers and sellers meet regularly to transact business. Although Upjohn,

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<sup>21</sup>Section 48(3), which deals with the *prima facie* measure of damages in the case of a seller's claim, reads as follows:

(3) Where there is an available market for the goods in question, the measure of damages is *prima facie* to be ascertained by the difference between the contract price and the market or current price at the time or times when the goods ought to have been accepted, or, if no time was fixed for acceptance, then at the time of the refusal to accept.

Section 49(3), which deals with the *prima facie* measure of damages in the case of a buyer's claim, provides:

(3) Where there is an available market for the goods in question, the measure of damages is *prima facie* to be ascertained by the difference between the contract price and the market or current price of the goods at the time or times when they ought to have been delivered, or, if no time was fixed, then at the time of the refusal to deliver.

<sup>22</sup>UCC 2-708(1) and UCC 2-713(1).

<sup>23</sup>(1878), 9 Ch. D. 20 (C.A.), at p. 25.

J., in *W. L. Thompson Ltd. v. Robinson (Gunmakers) Ltd.*,<sup>24</sup> considered himself bound by the test in the *Dunkirk Colliery* case, he thought it too restrictive, particularly in the light of the dramatic changes in marketing practices that had occurred since Lord Justice James' day. Upjohn, J., was of the view that a more appropriate test was one that asked whether "the situation in the particular trade in the particular area was such that the particular goods could freely be sold, and [whether] there was a demand sufficient to absorb readily all the goods that were thrust on it, so that if a purchaser defaulted, the goods in question could readily be disposed of". In *Charter v. Sullivan*,<sup>25</sup> Jenkins, L.J., found neither test entirely satisfactory. Although he did not offer his own test, he questioned whether there can be an available market in the statutory sense in the absence of the following factors:<sup>26</sup>

. . . unless those goods are available for sale in the market at the market or current price in the sense of the price, whatever it may be, fixed by reference to supply and demand as the price at which a purchaser for the goods in question can be found, be it greater or less than or equal to the contract price.<sup>27</sup>

The uncertainties surrounding the notion of an available market raise two questions. The first is whether the revised Act should adopt a definition of "available market". We are of the view that such a definition would merely engender new difficulties and, accordingly, we do not recommend the adoption in the revised Act of a definition of the term. The second question is whether market price terminology, including the concept of "available market", should be abandoned altogether in favour of a more flexible test. If it were decided to retain the concept of an available market and other market price terminology, a provision similar to UCC 2-723(2) would commend itself to us as a means of establishing the market price at a relevant date where it cannot otherwise be ascertained. UCC 2-723(2) provides as follows:

2-723.(2) If evidence of a price prevailing at the times or places described in this Article is not readily available the price prevailing within any reasonable time before or after the time described or at any other place which in commercial judgment or under usage of trade would serve as a reasonable substitute for the one described may be used, making any proper allowance for the cost of transporting the goods to or from such other place.

It has, however, been suggested to the Commission<sup>28</sup> that, because of the definitional difficulties mentioned earlier and because of other difficulties with the market price test discussed below, market price terminology should be abandoned. According to this suggestion, the seller's damages should be measured by the difference between the contract price and

<sup>24</sup>[1955] Ch. 177 (C.A.), at p. 187.

<sup>25</sup>[1957] 2 Q.B. 117 (C.A.).

<sup>26</sup>*Ibid.*, at p. 128.

<sup>27</sup>See, also, *Amicale Yarns Inc. v. Can. Worsted Mfg. Ltd.*, [1968] 2 O.R. 59, 64, (1968), 68 D.L.R. (2d) 131, 136 (H.C.J.).

<sup>28</sup>Baer, "Seller's Remedies", Research Paper No. III.9, pp. 56-58.

the price actually obtained by the seller in a commercially reasonable disposition of the goods. Alternatively, where the seller elects not to resell or fails to mitigate his damages, the measure of damages should be the difference between the contract price and what the seller *would* have obtained if he had disposed of the goods in a commercially reasonable manner. A similar test would be applied to measure the buyer's damages where the seller is in breach.

In chapters 16 and 17 of this Report, we recommended that the revised Act should adopt provisions similar to UCC 2-706 permitting a seller to resell,<sup>29</sup> and UCC 2-712 permitting a buyer to cover.<sup>30</sup> It will be apparent that these recommendations incorporate the first part of the test for the measure of damages suggested above; the recommended provisions on resale and cover permit the seller or buyer to measure his damages, not by the market price test, but by the difference between the contract price and the resale or cover price, as the case may be. The question that remains is whether a test of commercially reasonable disposition or purchase should also be applied where the seller or buyer has not in fact resold or covered.

Whatever its theoretical difficulties, the market price test has not worked badly in practice.<sup>31</sup> Moreover, the fact that the test has been retained in Article 2 of the *Uniform Commercial Code* is a further argument in favour of its retention in the revised Act. On the other hand, it may be said that Article 2 has greatly diminished the importance of the market price test, and that, if a formula is desirable to measure damages where no resale or cover has taken place, a test based upon a hypothetical commercial resale or purchase at least has the merit of forming a conceptual continuum with the actual resale and cover provisions. Another point in favour of adopting the proposed test is that it would avoid some of the definitional difficulties engendered by the concept of an available market, and would give the courts greater flexibility in assessing damages. Although we consider the arguments to be fairly evenly balanced, we have concluded that the revised Act should adopt a test of commercially reasonable disposition or purchase in preference to the market price test contained in sections 48(3) and 49(3) of the existing Sale of Goods Act. Accordingly, we recommend that, where the buyer wrongfully neglects or refuses to accept and pay for the goods at the agreed time for performance and in circumstances amounting to a substantial breach, and the seller has not actually resold, the measure of the seller's damages should *prima facie* be ascertained by the difference between the contract price and the price that could have been obtained by a commercially reasonable disposition of the goods, less any expenses saved in consequence of the buyer's breach.<sup>32</sup> Similarly, where the seller wrongfully neglects or refuses to deliver at the agreed time for performance and in circumstances amounting to a substantial breach, or where the buyer rightfully rejects or revokes accep-

<sup>29</sup>*Supra*, ch. 16, sec. 2(b)(iii).

<sup>30</sup>*Supra*, ch. 17, sec. D. 3(c).

<sup>31</sup>Compare, Lawson "An Analysis of the Concept of 'Available Market'" (1969), 43 A.L.J. 106, at p. 114.

<sup>32</sup>See, Draft Bill, s. 9.10(3).

tance of the goods, and the buyer has not actually covered, the measure of the buyer's damages should *prima facie* be ascertained by the difference between the contract price and the price at which the goods could have been obtained in a commercially reasonable purchase, less any expenses saved in consequence of the seller's breach.<sup>33</sup>

It should be noted that this *prima facie* test applies to measure the seller's damages where the buyer wrongfully neglects or refuses to accept and pay for the goods at the agreed time for performance and in circumstances amounting to a substantial breach. Similarly, the *prima facie* test applies to measure the buyer's damages where, at the agreed time for performance and in circumstances amounting to a substantial breach, the seller wrongfully neglects or refuses to deliver the goods, or where the buyer rightfully rejects or revokes his acceptance of the goods. In other cases, the measure of the seller's and buyer's damages is governed by the general *Hadley v. Baxendale* formula recommended for adoption in the revised Act.<sup>34</sup>

(b) THE PLACE FOR DETERMINATION OF COMMERCIALLY  
REASONABLE PRICE

*The Sale of Goods Act* provides no guidance as to the geographical location of the market whose prevailing prices are to determine the measure of the seller's or buyer's loss. Much may turn on this question, particularly where the buyer and seller are far apart or trade in different markets. The following example will illustrate this proposition. Let us suppose that S, a seller in Vancouver, sells to B, a buyer in Toronto, a consignment of walnuts f.o.b. Vancouver. If B wrongfully rejects the walnuts while they are in transit or after their arrival in Toronto, the prospects are that S will try to resell the walnuts in the Toronto market. *The Sale of Goods Act* is silent as to whether the loss should be measured with reference to the price prevailing at the place of tender or at the place of destination. If, in our example, the place of tender (that is, Vancouver) is to determine S's *prima facie* loss, and if the price of walnuts is lower in Toronto, where S resells, S's recovery of damages against B may be insufficient to cover his actual loss. The sparse case law<sup>35</sup> offers only limited guidance as to the place at which the seller's loss is *prima facie* to be measured, and it seems desirable that the position should be clarified in the revised Act.

Article 2 adopts different tests to determine the place of the market, depending on whether it is the seller or the buyer who is claiming damages. In the case of a claim by the seller, the place of the market is stated to be the place where tender is to be, or presumably has been, made.<sup>36</sup>

<sup>33</sup>See, Draft Bill, s. 9.16(3).

<sup>34</sup>See, *supra*, ch. 17, sec. D; and see, also, Draft Bill, ss. 9.10(2) and 9.16(2).

<sup>35</sup>For example, *Hasell v. Bagot, Shakes & Lewis Ltd.* (1911), 13 C.L.R. 374 (Aust. H.C.); *Aryeh v. Lawrence Kostoris & Son Ltd.*, [1967] 1 Lloyd's Rep. 63 (C.A.); *Benjamin's Sale of Goods* (1974), paras. 1264, 1617. For the divergent pre-Code U.S. and other authorities, see, Sassoone, *C.I.F. and F.O.B. Contracts* (2nd ed., 1975), secs. 512-14, 521.

<sup>36</sup>UCC 2-708(1).

The place of tender governs the measure of the seller's loss whether the claim arises because of the buyer's wrongful rejection of the goods after their arrival, or because of the buyer's repudiation of the contract before he receives the goods. The inflexibility of this test has rightfully been criticized.<sup>37</sup> In the case of a claim for damages by the buyer, the market price is to be determined as of the place of tender if the seller fails to deliver or repudiates; where the buyer rejects the goods after arrival or revokes his acceptance, the market price is to be determined as of the place of arrival.<sup>38</sup> However, even this bifurcated test may create difficulties, as the following example illustrates. Suppose that a consignment of nylon yarn is purchased by a Toronto buyer from a New York merchant for shipment f.o.b. Tokyo. In accordance with the Code rule, Tokyo will then be the place of tender of the goods. It is difficult to believe that, if the seller fails to deliver or repudiates, Tokyo would also be the most appropriate market by which to measure the buyer's loss. Presumably, the Toronto buyer would have purchased the goods in Japan if he had had the right connections in the overseas market. This example demonstrates the undesirability of tying the courts' hands. Given the infinite variety of goods, parties, market places and their interaction with each other, we do not favour the adoption of a rigid test to determine the place for measuring the damages deemed to have been suffered by an aggrieved buyer or seller. Accordingly, we recommend that, for the purpose of measuring the buyer's or seller's loss, the revised Act should contain a simple rule that the price that could have been obtained by a commercially reasonable disposition or purchase of the goods shall be the price obtaining at a reasonable place. We so recommend.<sup>39</sup>

(C) THE TIME FOR DETERMINATION OF COMMERCIALY  
REASONABLE PRICE

Section 49(3) of *The Sale of Goods Act* provides that, where the seller neglects or refuses to deliver, the market price is to be determined as of the time or times when the goods ought to have been delivered; where, on the other hand, no time is fixed for delivery, the market price is to be determined as at the time of the refusal to deliver. The same test is applied, *mutatis mutandis*, in section 48(3) of *The Sale of Goods Act* where the buyer is in default. In both cases, the test gives rise to difficulties.<sup>40</sup> First, it requires the buyer to respond with what may be unreasonable haste to cover his position where he has been let down by the seller.<sup>41</sup>

<sup>37</sup>Peters, "Remedies for Breach of Contracts Relating to the Sale of Goods under the Uniform Commercial Code: A Roadmap for Article Two" (1963), 73 Yale L.J. 199, at pp. 257-58; White & Summers, *Handbook of the Law Under the Uniform Commercial Code* (1972), at p. 222.

<sup>38</sup>UCC 2-713(2).

<sup>39</sup>See, Draft Bill, ss. 9.10(3) and 9.16(3).

<sup>40</sup>Compare, *McGregor on Damages* (13th ed., 1972), para. 636.

<sup>41</sup>In practice, the courts do not always apply the statutory requirements with such strict literalism, and indeed it may not always be easy to establish the actual date of breach. Compare, *C. Sharpe & Co. Ltd. v. Nosawa & Co.*, [1917] 2 K.B. 814; *R.V. Ward Ltd. v. Bignall*, [1967] 1 Q.B. 534 (C.A.); see, also, *Asamera Oil Corp. Ltd. v. Sea Oil & General Corp. and Baud Corp. N.V.* (1978), 23 N.R. 181 (S.C.C.), at pp. 211-12, citing with approval Atiyah, *The Sale of Goods* (4th ed., 1971), at p. 294.

Secondly, it is unclear whether, in the case of an anticipatory repudiation where no time is fixed for delivery, the time for determination of the market price is to be governed by section 49(3), or by the general common law test applicable to cases of anticipatory repudiation. The common law rule applicable to cases of anticipatory repudiation is that the time for determination of the market price is the time when performance is due, not the time of repudiation, unless the repudiation has been accepted, in which case other considerations come into play. A literal reading of section 49(3) would lead to the conclusion that, in the case of an anticipatory repudiation where no time has been fixed for delivery, damages are to be assessed as of the time of refusal to deliver, even though the time of performance has not arrived and the buyer has not accepted the repudiation.<sup>42</sup> The third difficulty is that it is unsettled whether a delivery that is to be made within a reasonable time constitutes a "fixed time" for the purpose of the section.<sup>43</sup> Finally, the test is inappropriate where there is some delay between the date of delivery and the date of rightful rejection of the goods by the buyer, assuming that section 49 applies at all in this situation.

Article 2 of the *Uniform Commercial Code* provides what appear to be reasonable solutions to most of these problems. Its provisions with respect to cover,<sup>44</sup> and with respect to resale,<sup>45</sup> substantially relieve against the rigours of the immediate response requirement. However, the aggrieved party may not have covered, or resold as the case may be, at the time the dispute comes to trial. We have concluded that, in such a case, damages should *prima facie* be measured with reference to the price that the buyer would have paid for substitutional goods, or that the seller could have obtained in a commercially reasonable resale, "within . . . a reasonable time" after the buyer or seller "learned" of the other's breach.<sup>46</sup> A precedent for this approach is provided by UCC 2-713(1), which, in the case of non-delivery or repudiation by the seller, measures the buyer's damages with reference to the time when the buyer "learned" of the seller's breach.

So far as the other difficulties that we have mentioned are concerned, UCC 2-610 and related provisions, including, particularly, UCC 2-704, deal with the second difficulty, the effect of an anticipatory repudiation. These provisions are referred to more fully hereafter.<sup>47</sup> The Code does not address itself specifically to the case where no time is fixed for de-

<sup>42</sup>Compare, *Melachrino v. Nickoll & Knight*, [1920] 1 K.B. 693; *Millett v. Van Heek & Co.*, [1921] 2 K.B. 369 (C.A.), approved in *Tai Hing Cotton Mill Ltd. v. Kamsing Knitting Factory*, [1978] 1 All E.R. 515(P.C.). See, further, *infra*, this ch., at pp. 539 *et seq.*

<sup>43</sup>*Millett v. Van Heek & Co.*, footnote 42 *supra*; and compare the suggestion in the *Tai Hing Cotton* case, footnote 42 *supra*, at p. 522, that "on analysis [this limb of Ontario SGA s.49(3)] proves, exceptionally, to have no content whatever".

<sup>44</sup>See, UCC 2-712.

<sup>45</sup>See, UCC 2-706.

<sup>46</sup>See, Draft Bill, ss. 9.10(3) and 9.16(3); and compare, UCC 2-723(2) which provides, *inter alia*, that if evidence of a price prevailing at the times or places described in Article 2 is not readily available the price prevailing within any reasonable time before or after the time described may be used as a reasonable substitute.

<sup>47</sup>*Infra*, sec. 4.

livery, but the test in UCC 2-713(1), that the market price is to be determined as of the time when the buyer learned of the breach, appears adequate to meet the situation. Finally, it is clear from UCC 2-713(2) that this "learning" test also applies in cases of rejection or revocation of acceptance.

Once again, however, there is some inconsistency in Article 2:<sup>48</sup> in the case of non-acceptance by the buyer, the relevant time for assessing the seller's loss is, as provided by UCC 2-708(1), the time of the non-acceptance by the buyer of the goods or documents of title. This test is clearly unsatisfactory where the seller does not learn of the buyer's breach until the goods reach their destination, and the destination is not the same as the place of tender. We would not, therefore, confine the test in UCC 2-713(1) to breaches by the seller. Accordingly, we recommend that the revised Act should incorporate a test, in place of the test contained in sections 48(3) and 49(3) of the existing Sale of Goods Act, to the effect that the aggrieved party's damages shall be determined with reference to the price at which the goods could have been resold or purchased, as the case may be, within a reasonable time after the aggrieved party learned of the breach by the other party.<sup>49</sup>

#### (d) CONCLUSIONS

It will be convenient to set out at this stage the provisions<sup>50</sup> governing the *prima facie* test of the seller's and buyer's damages that we recommend should be included in the revised Act in place of sections 48(3) and 49(3) of the existing Sale of Goods Act:

9.10(3) Where at the agreed time for performance and in circumstances amounting to a substantial breach the buyer wrongfully neglects or refuses to accept and pay for the goods and section 9.9 does not apply, the measure of damages is *prima facie* to be ascertained by the difference between the contract price and the price that could have been obtained by a commercially reasonable disposition of the goods within or at a reasonable time and place after the seller learned of the buyer's breach, less any expenses saved in consequence of the buyer's breach.

9.16(3) Where, at the agreed time for performance and in circumstances amounting to a substantial breach, the seller wrongfully neglects or refuses to deliver the goods to the buyer, or where the buyer rightfully rejects or revokes acceptance, and section 9.15 does not apply, the measure of damages is *prima facie* to be ascertained by the difference between the contract price and the price at which the goods could have been obtained in a commercially reasonable purchase within or at a reasonable time and place after the buyer learned

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<sup>48</sup>See, White & Summers, *Handbook of the Law Under the Uniform Commercial Code* (1972), at p. 221.

<sup>49</sup>See, Draft Bill, ss. 9.10(3) and 9.16(3).

<sup>50</sup>*Ibid.*

of the seller's breach of contract, less any expenses saved in consequence of the seller's breach.

### 3. ASSURANCE OF PERFORMANCE

An important innovation in Article 2 is the right that it confers upon a seller or buyer under specified conditions to seek "adequate assurance of due performance" from the other party. The germ of the concept already exists in *The Sale of Goods Act*,<sup>51</sup> but it has been much enlarged in UCC 2-609. Sections 39(1)(c) and 42 of *The Sale of Goods Act*, respectively, entitle the seller to withhold delivery or to exercise a right of stoppage where the buyer is insolvent, whether or not payment is otherwise due. The underlying rationale of sections 39(1)(c) and 42 is that insolvency of the buyer manifests an inability to fulfill his part of the bargain and, therefore, makes it unfair to require the seller to proceed with his obligations under the contract.

The difficulty with sections 39(1)(c) and 42 is that they are too narrow. For instance, either the seller or the buyer may have reasonable grounds to believe that his prospects of receiving performance from the other are impaired even though no question of insolvency is involved. Or again, the party seeking assurance of performance may have information that falls short of showing clearly the other party's inability or unwillingness to perform; the information may be equivocal. Furthermore, the aggrieved party may wish not to have to assess the import of the available evidence with respect to the likelihood of non-performance, or may not be in a position to do so accurately. He may simply wish to require the other party to allay his concerns.

It is these varying circumstances that UCC 2-609 seeks to address. UCC 2-609 provides as follows:

2-609.(1) A contract for sale imposes an obligation on each party that the other's expectation of receiving due performance will not be impaired. When reasonable grounds for insecurity arise with respect to the performance of either party the other may in writing demand adequate assurance of due performance and until he receives such assurance may if commercially reasonable suspend any performance for which he has not already received the agreed return.

(2) Between merchants the reasonableness of grounds for insecurity and the adequacy of any assurance offered shall be determined according to commercial standards.

(3) Acceptance of any improper delivery or payment does not prejudice the aggrieved party's right to demand adequate assurance of future performance.

(4) After receipt of a justified demand failure to provide within a reasonable time not exceeding thirty days such assurance of due

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<sup>51</sup>NYLRC Study, ch. 5, footnote 52, *supra*, pp. (535)-(537). See, also, Wardrop, "Prospective Inability in the Law of Contracts" (1936), 20 Minn. L. Rev. 380.

performance as is adequate under the circumstances of the particular case is a repudiation of the contract.

It will be observed that the section has three principal components. First, it entitles the aggrieved party to seek adequate assurance of due performance when "reasonable grounds for insecurity" arise with respect to performance by the other party.<sup>52</sup> The Official Comment to the section makes it clear that the grounds of insecurity need not be restricted to factors involving the particular contract. For example, delay in the payment of earlier accounts or the delivery of defective goods of the same type to other buyers may suffice.<sup>53</sup> Secondly, until the assurance is furnished, the aggrieved party may suspend his own performance. Thirdly, failure to supply the assurance amounts to a repudiation and will entitle the aggrieved party to exercise the remedies available to him when repudiation occurs.

We support the principle of UCC 2-609<sup>54</sup> and regard it as one of the most useful innovations in the performance provisions of Article 2. Accordingly, we recommend that a comparable section be included in the revised Act.<sup>55</sup> However, UCC 2-609 raises several issues of interpretation that merit attention. We now turn to discuss these issues.

The first difficulty relates to the opening sentence of subsection (1), which provides that "[a] contract for sale imposes an obligation on each party that the other's expectation of receiving due performance will not be impaired". Read in conjunction with UCC 1-106(2),<sup>56</sup> this suggests that an action will lie whenever the other party's expectation of due performance has been impaired. Presumably this was not intended, and the draftsmen's intention was to limit the aggrieved party's remedy to an assurance of due performance. Our view is that the sentence is superfluous, as well as potentially misleading. Accordingly, we recommend that it should not be incorporated in the comparable provision in the revised Act.<sup>57</sup>

Secondly, UCC 2-609(2) stipulates that, between merchants, the reasonableness of grounds for insecurity and the adequacy of any assurance offered shall be determined according to "commercial" standards. In addition, UCC 2-609(1) stipulates that the aggrieved party may, while he is awaiting adequate assurance, suspend performance if it is "commercially" reasonable. On balance the Commission has decided that such

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<sup>52</sup>"Performance" has been read broadly by the courts and will include a case where a buyer complains of malfunctioning equipment. See, *Lockwood-Conditionaire Corp. v. Educational Audio Visual, Inc.* (1966), 3 U.C.C. Rep. Serv. 354 (N.Y. Sup. Ct.). It is open to question, however, whether UCC 2-609 was intended to apply to a case of defective present performance as well as *prospective* inability to perform. UCC 2-609, Comment 1, suggests a restrictive view.

<sup>53</sup>UCC 2-609, Comment 3.

<sup>54</sup>A similar provision appears in the 1977 draft UNCITRAL Convention, Art. 48.

<sup>55</sup>See, Draft Bill, s. 8.9.

<sup>56</sup>UCC 1-106(2) reads as follows:

Any right or obligation declared by this Act is enforceable by action unless the provision declaring it specifies a different and limited effect.

<sup>57</sup>See, Draft Bill, s. 8.9(1).

restrictions are unnecessary and may unduly limit the exercise of the aggrieved party's rights under the section. Therefore, we do not recommend the inclusion in the revised Act of a provision comparable to UCC 2-609 (2), and we recommend that the word "commercially" in the phrase "commercially reasonable" in UCC 2-609(1) should not be incorporated in the corresponding provision in the revised Act.<sup>58</sup>

Thirdly, it is not clear from the language of UCC 2-609 to what extent the contract may impose or permit standards deviating from those incorporated in the section. The section is not mandatory in its terms. For example, is a clause entitling the seller to cancel a contract whenever he deems himself insecure permissible, where the seller himself is the sole judge of his insecurity? It appears from the Comments to UCC 2-609<sup>59</sup> that the draftsmen intended to restrict the parties' right to vary the statutory standards both by the general requirement of good faith and by the explicit requirement in subsection (1) of "reasonable grounds for insecurity". Since the same question arises in other sections involving the exercise of rights and duties, we have concluded that the extent to which the contract may impose or permit standards deviating from those incorporated in the section should be governed by the proposed general provision in the revised Act<sup>60</sup> delineating the extent to which the parties are free to vary the provisions of the Act. We so recommend.

Fourthly, there is also some doubt whether an assurance of due performance can be sought even though the aggrieved party has already fulfilled his part of the contract. For example, can a seller demand assurance of payment where goods have been delivered on credit and, thereby, accelerate unmatured obligations if the assurance is not forthcoming?<sup>61</sup> Subsection (1) does not restrict the right to demand an assurance to cases where the aggrieved party's performance is still executory, although such a reading would be consistent with the rationale of the section and the right to suspend performance conferred by subsection (1). Our view, however, is that ample room should be left for flexible interpretation of the section in the light of its underlying purposes. Accordingly, we recommend that the provision in the revised Act corresponding to UCC 2-609 should not be expressly restricted to cases where the person seeking adequate assurance of performance has not performed his obligations under the contract.

Finally, the legal implications of the right to suspend performance may need to be spelled out more fully. Obviously, the aggrieved party will not be in breach for withholding performance while he awaits the assurance of performance. However, having received the assurance, it may be asked whether he can postpone completion of his performance by a period equivalent to the delay between the request for the assurance

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<sup>58</sup>*Ibid.*

<sup>59</sup>Comments 4 and 6.

<sup>60</sup>See, Draft Bill, s. 3.1.

<sup>61</sup>NYLRC Study, ch. 5, footnote 52, *supra*, p. (539), and see, also, *Wrightstone Inc. v. Motter* (1961), 1 U.C.C. Rep. Serv. 170 (Pa. C.P.), criticized in White & Summers, *Handbook of the Law Under the Uniform Commercial Code* (1972), p. 170, n. 11.

and its receipt, or whether the period depends on the circumstances of each case. If the delay has caused other forms of prejudice to the aggrieved party, will this entitle him to a longer period to complete performance, or even excuse him altogether? Similar questions arise in the case of an anticipatory repudiation<sup>62</sup> that is retracted by the repudiating party before the aggrieved party has acted on it. In such a case, UCC 2-611(3) provides as follows:

2-611.(3) Retraction reinstates the repudiating party's rights under the contract with due excuse and allowance to the aggrieved party for any delay occasioned by the repudiation.

The meagre case law under UCC 2-609 provides few answers to these questions concerning the legal implications of the right to suspend. There is, however, persuasive evidence from two sources that the draftsmen intended the party seeking assurance of performance to be excused for any reasonable delay occasioned by his justifiable apprehensions. The first source is found in Comment 2 to the section, which explicitly recognizes such a consequence; the second, and still more significant, source is provided by UCC 2-609(1), which authorizes the aggrieved party "to suspend" any performance for which he has not already received the agreed return. Obviously, suspension of an obligation due at that time must result in a delay. It may be, therefore, that the key to the questions we have raised is already found within the language of the section. Nevertheless, to resolve any lingering doubt we recommend the adoption of a further provision<sup>63</sup> to make it clear that, upon adequate assurance being provided, the aggrieved party's obligation to perform is restored, but that he is not liable for any delay occasioned by his suspension of performance. Admittedly, this proposal does not indicate the *length* of the delay to which the aggrieved party is entitled, but this question does not admit of a quantifiable answer. It will depend on the circumstances.

Neither UCC 2-609 nor our recommended version of UCC 2-609 matches the provisions of UCC 2-611(3) dealing with the effects of retraction of an anticipatory repudiation. Neither provision confers on the aggrieved party the right to an "allowance" for any delay occasioned by his suspension of performance while awaiting assurance. However, we think there is a justifiable distinction. UCC 2-611 involves a breach by the repudiating party, whereas UCC 2-609 requires no breach, conscious or otherwise. It would not be right, therefore, to hold liable in damages the person who has given the assurance. Accordingly, we recommend that the provision in the revised Act comparable to UCC 2-609, unlike UCC 2-611(3), should not confer upon the aggrieved party the right to an allowance for any delay occasioned by the aggrieved party's suspension of performance.

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<sup>62</sup>Anticipatory repudiation will be considered in the next section of this chapter.

<sup>63</sup>See, Draft Bill, s. 8.9(4).

4. ANTICIPATORY REPUDIATION<sup>64</sup>

## (a) COMPARISON OF ANGLO-CANADIAN AND AMERICAN POSITIONS

When a contracting party declares his intention not to honour a future obligation, or puts it out of his power to do so, he is said to be guilty of anticipatory repudiation. The expression is an unfortunate one, since it suggests that the aggrieved party's concern is solely with the prospect of a future breach, whereas it may fairly be argued<sup>65</sup> that the repudiating party's conduct also amounts to a present breach; that is, the breach of an obligation not to impair the other party's expectation of future performance. The problem of characterization is indicative of the much more serious difficulties that the Anglo-Canadian courts have experienced in putting the doctrine of anticipatory repudiation on a sound theoretical footing. The difficulties are still with us and, though the doctrine is not peculiar to sales law, it is of particular importance in this area. It is desirable, therefore, that the revised Act should seek to eliminate some of the more obvious defects in the existing rules.

The first defect arises out of the well-established rule that traces its origin to Chief Justice Cockburn's classic judgment in *Frost v. Knight*.<sup>66</sup> In that case, it was held that on learning of the repudiation, the aggrieved party is put to his election: he may either accept the repudiation, in which case the contract is deemed to be at an end except for the purpose of entitling the aggrieved party to sue for breach, or he may ignore the repudiation. In the latter event, the contract remains in force for all purposes, and both parties are bound to continue with the contract as if the wrongful act had never occurred. The consequences of affirming the contract, or being deemed to have done so,<sup>67</sup> are serious. For one thing, if the innocent party affirms the contract he cannot later change his mind and rescind because of the earlier breach.<sup>68</sup> Again, he cannot suspend performance of his own obligations even though there is no assurance that the party repudiating will retract his repudiation. On the other hand, it appears to be settled law that an innocent party who does not accept the repudiation is under no duty to mitigate his damages prior to the time when the repudiating party's performance actually becomes due. Indeed, the decision of the House of Lords in *White and Carter (Councils)*

<sup>64</sup>For a general discussion of this topic, see, Carr, "Anticipatory Repudiation and Mitigation of Damages", Research Paper No. III.8.

<sup>65</sup>Compare, *Maredelanto Compania Naviera SA v. Bergbau-Handel GmbH The Mihalis Angelos*, [1970] 3 W.L.R. 601, [1970] 3 All E.R. 125 (C.A.) per Denning, M.R., at p. 131; *Frost v. Knight* (1872), L.R. 7 Ex. 111 at p. 114; and McRae, footnote 14 *supra*, at pp. 260-61, reviewing earlier scholarly discussions with respect to the question.

<sup>66</sup>(1872), L.R. 7 Ex. 111; *Benjamin's Sale of Goods* (1974), paras. 1235-37; Treitel, *The Law of Contract* (4th ed., 1975), pp. 579-82; Waddams, *The Law of Contracts* (1977), pp. 384 *et seq.*

<sup>67</sup>Compare, *Avery v. Bowden* (1856), 6 El. & Bl. 953, 119 E.R. 1119 (Exch.); *Dalrymple v. Scott* (1892), 19 O.A.R. 477.

<sup>68</sup>Unless the other party continues to repudiate: *Benjamin's Sale of Goods* (1974), paras. 1237, 1274.

*Ltd. v. McGregor*<sup>69</sup> supports the proposition that, at least in some circumstances, the aggrieved party may recover avoidable expenditures incurred after he learned of the repudiation, even though the expenditures may be of no benefit to the repudiating party. This result has been much criticized.

In contrast to Anglo-Canadian law, the American common law adopts a more flexible attitude.<sup>70</sup> The innocent party is not bound to elect. He may accept the repudiation and terminate the contract, but failure to do so, or his urging the other party to retract his repudiation, does not amount to an affirmation of the contract.<sup>71</sup> The breach is not effaced unless the repudiating party retracts the repudiation. The repudiating party is free to retract his repudiation at any time before the innocent party acts upon or accepts it, and, contrary to the usual rule applicable to contractual breaches, an effective retraction nullifies the repudiation.<sup>72</sup> Until there is retraction, the innocent party may suspend his own performance and continue to urge retraction without prejudicing his other rights.<sup>73</sup> If there is no retraction the innocent party can still terminate the contract and sue for breach. In any event, the innocent party must act in conformity with the normal rules governing mitigation of damages<sup>74</sup> and, in particular, he must not incur avoidable expenditures that enhance his loss unjustifiably.<sup>75</sup>

These rules have been substantially reproduced in UCC 2-610 and 2-611,<sup>76</sup> albeit in such a form that this fact would not be obvious to a reader unfamiliar with the American common law principles. The sections read as follows:

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<sup>69</sup>[1962] A.C. 413 (H.L. (Sc.)); as to which, see, *inter alia*, Goodhart, "Measure of Damages When a Contract is Repudiated" (1962), 78 L.Q.R. 263; Nienaber, "The Effect of Anticipatory Repudiation: Principle and Policy", [1962] Cam. L.J. 213; and Treitel, *The Law of Contract* (4th ed., 1975), pp. 675-78. The decision was distinguished by the Ontario Court of Appeal in *Finelli v. Dee*, [1968] 1 O.R. 676, (1968), 67 D.L.R. (2d) 393 (C.A.). See, also, *Hounslow London B.C. v. Twickenham Garden Dev. Ltd.*, [1971] 1 Ch. 233, at pp. 254-57.

<sup>70</sup>*Williston on Contracts* (3rd ed., 1957), secs. 1300 *et seq.*; *Williston on Sales* (Rev. ed., 1948), secs. 584 *et seq.*; *Restatement of the Law of Contracts* (1932), secs. 318 *et seq.*; *Restatement of the Law, Contracts 2d, Tent. Draft No. 8* (1973), secs. 274 *et seq.*

<sup>71</sup>See the leading judgment of Baker, J., in *Lagerloef Trading Co. Inc. v. American Paper Products Co. of Indiana* (1923), 291 F. 947 (C.A.); *Williston on Sales* (Rev. ed., 1948), sec. 585f. As Williston observes in Vol. 3, sec. 585d, p. 257, in criticizing the English rule, "[w]hen A repudiates his promise, what is more natural or reasonable than for B to write urging him to perform".

<sup>72</sup>*Restatement of the Law of Contracts* (1932), sec. 319; *Restatement of the Law, Contracts 2d, Tent. Draft No. 8* (1973), sec. 278.

<sup>73</sup>*Restatement of the Law of Contracts* (1932), sec. 320; *Restatement of the Law, Contracts 2d, Tent. Draft No. 8* (1973), sec. 280.

<sup>74</sup>*Restatement of the Law of Contracts* (1932), secs. 336(1), 338, Comment c to sec. 338.

<sup>75</sup>*Williston on Sales* (Rev. ed., 1948), sec. 589. This branch of the mitigation rule was established as early as *Clark v. Marsiglia* (1845), 1 Denio 317, 43 Am. Dec. 670 (N.Y.).

<sup>76</sup>Compare, NYLRC, ch. 5, footnote 52, *supra*, pp. (669)-(676), commenting on an earlier version of UCC 2-610 and UCC 2-611, and Taylor, "The Impact of Article 2 of the U.C.C. on the Doctrine of Anticipatory Repudiation" (1968), 9 B.C. Ind. & C.L. Rev. 917.

## UCC 2-610

When either party repudiates the contract with respect to a performance not yet due the loss of which will substantially impair the value of the contract to the other, the aggrieved party may

- (a) for a commercially reasonable time await performance by the repudiating party; or
- (b) resort to any remedy for breach (Section 2-703 or Section 2-711), even though he has notified the repudiating party that he would await the latter's performance and has urged retraction; and
- (c) in either case suspend his own performance or proceed in accordance with the provisions of this Article on the seller's right to identify goods to the contract notwithstanding breach or to salvage unfinished goods (Section 2-704).

## UCC 2-611

(1) Until the repudiating party's next performance is due he can retract his repudiation unless the aggrieved party has since the repudiation cancelled or materially changed his position or otherwise indicated that he considers the repudiation final.

(2) Retraction may be by any method which clearly indicates to the aggrieved party that the repudiating party intends to perform, but must include any assurance justifiably demanded under the provisions of this Article (Section 2-609).

(3) Retraction reinstates the repudiating party's rights under the contract with due excuse and allowance to the aggrieved party for any delay occasioned by the repudiation.

These provisions present some problems of interpretation, which will be examined below. For the moment it will suffice to draw attention to the salient features of the two sections.

UCC 2-610 states the basic rights of the innocent party. He may either, for a commercially reasonable time, await performance by the repudiating party, or he may resort immediately to any remedy for breach. In either event he may suspend his own performance, and he is free to urge the repudiating party to retract his repudiation. It is clear, therefore, that the aggrieved party is under no obligation to elect between acceptance and rejection of the repudiation. UCC 2-610 makes no explicit reference to the innocent party's duty to mitigate his damages, but the duty appears to be implied in UCC 2-610(a),<sup>77</sup> and to this extent his freedom of action is not unqualified.

UCC 2-611 states the circumstances in which the repudiating party may retract his repudiation. He may do so unless one of the three events

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<sup>77</sup>Compare, *Oloffson v. Coomer* (1973), 296 N.E. 2d 871 (Ill. App. Ct.).

described in subsection (1) has occurred. However, retraction does not completely “cure” the breach; the aggrieved party, exercising his rights under UCC 2-609, discussed in a previous section of this chapter, may demand an “adequate assurance” that the party retracting his repudiation will honour his obligations. In any event, the aggrieved party is entitled to “due excuse and allowance” for any delay occasioned by the repudiation.

## (b) CONCLUSIONS

We are of the view that the Code’s rules on anticipatory repudiation are preferable to the Anglo-Canadian rules. Subject to a number of changes mentioned below, we are of the opinion that they should be adopted in the revised Ontario Act. The Anglo-Canadian rules suffer from two principal weaknesses. The first weakness is that the rules proceed from the premise that there is an inherent distinction between breach of a present obligation to perform and breach by anticipatory repudiation. The distinction breaks down, however, once it is conceded that breach by anticipatory repudiation also involves breach of a present obligation — the obligation not to impair the other party’s rightful expectation of performance. Indeed, this must be so for, if there were no such present breach, it would be difficult to justify the other party’s right to bring an action for damages before the due date for performance. It follows that other and more persuasive reasons must be given for attaching basically different consequences to these two types of breach than are offered under existing Anglo-Canadian law. The other weakness is that the existing rules subordinate an aggrieved party’s general duty to mitigate his damages, to the “higher” principle that a contract breaker cannot impose cancellation of the contract on the other party.<sup>78</sup> Modern American law, broadly speaking, has managed to avoid both these weaknesses. We have, therefore, concluded that, subject to the matters discussed below, there should be included in the revised Act sections comparable to UCC 2-610<sup>79</sup> and UCC 2-611,<sup>80</sup> and we so recommend.

While we support the Code provisions we do not favour verbatim adoption of UCC 2-610 and 2-611. We proceed to discuss five difficulties of interpretation and our responses to them.

### (i) *Meaning of Repudiation*

The opening paragraph of UCC 2-610 does not attempt to define the circumstances in which a party’s conduct will amount to repudiation. However, some guidance is to be found in Official Comments 1 and 2 to the section, portions of which state as follows:

#### Comment 1

... anticipatory repudiation centers upon an overt communication of intention or an action which renders performance impossible or demonstrates a clear determination not to continue with performance.

<sup>78</sup>Carr, footnote 64 *supra*, at pp. 4, 19 *et seq.*

<sup>79</sup>See, Draft Bill, s. 8.10.

<sup>80</sup>See, Draft Bill, s. 8.11.

## Comment 2

It is not necessary for repudiation that performance be made literally and utterly impossible. Repudiation can result from action which reasonably indicates a rejection of the continuing obligation. . . .

These tests coincide substantially with the tests adopted in the *Restatement of the Law of Contracts*<sup>81</sup> and in the *Second Restatement on Contracts*,<sup>82</sup> and with the law as generally understood in England and Canada.<sup>83</sup> The difficulty, however, is not in defining the term but in applying it to particular facts. Since a statutory definition will not resolve this problem, we see little point in adding a definition to the Ontario version of UCC 2-610. Accordingly, we do not recommend that a definition of repudiation be included in the revised Act.

(ii) *Meaning of UCC 2-610(a)*

American commentators have encountered difficulties in construing clause (a) of UCC 2-610 and in determining the consequences of an aggrieved party awaiting performance by the repudiating party for more than a commercially reasonable time. It has been conjectured<sup>84</sup> that the Code's draftsmen probably intended that an aggrieved party who awaits performance for more than a commercially reasonable period should lose his right to cover or to recover consequential damages that he might otherwise have been able to avoid, but that failure to "cover" was not intended to prejudice his other remedies such as the right to recover the contract-market price differential under UCC 2-713 or the seller's corresponding right under UCC 2-708. The draftsmen themselves, while not advertent specifically to clause (a), seem to have had in mind the aggrieved party's inability to recover damages that he could have avoided if he had not waited for more than a commercially reasonable period. The relevant portion of Comment 1 states as follows:

Under the present section when such a repudiation substantially impairs the value of the contract, the aggrieved party may at any time resort to his remedies for breach, or he may suspend his own performance while he negotiates with, or awaits performance by, the other party. But if he awaits performance beyond a commercially reasonable time he cannot recover resulting damages which he should have avoided.

With the benefit of hindsight one could suggest that such a general principle of mitigation could have been expressed more clearly. We return below to this question.

<sup>81</sup>*Restatement of the Law of Contracts* (1932), sec. 318.

<sup>82</sup>*Restatement of the Law, Contracts 2d, Tent. Draft No. 8* (1973), sec. 274.

<sup>83</sup>Fridman, *The Law of Contract in Canada* (1976), pp. 519-20.

<sup>84</sup>White & Summers, *Handbook of the Law Under the Uniform Commercial Code* (1972), pp. 204 *et seq.*

(iii) *Effect of Urging Retraction: UCC 2-610(b)*

UCC 2-610(b) provides that, in the case of anticipatory repudiation, the aggrieved party may resort to any remedy for breach, even though he has notified the repudiating party that he would await performance by the repudiating party and has urged the repudiating party to retract. A literal reading of clause (b) leads to the conclusion that the innocent party is free to resort to any remedy for breach, even though the repudiating party's performance is prejudicially affected by the innocent party's unannounced change of position. It seems unlikely that the draftsmen intended to adopt such an uncompromising position, since it would conflict with the Code's general concepts of good faith and fair dealing.<sup>85</sup> Presumably, their intention was to protect the aggrieved party against an unwitting waiver of his rights. We think the distinction between protecting the aggrieved party against such a waiver of his rights and allowing the aggrieved party to change his position, even if it prejudices the repudiating party, should be made clear. It is important to avoid hardship to a repudiating party who has suffered foreseeable detriment or loss as the result of a notification by the aggrieved party that he would await performance by the repudiating party, or because the aggrieved party has urged the repudiating party to perform in spite of his repudiation. Accordingly, we recommend the addition of the following provision to the section in the revised Act comparable to UCC 2-610:<sup>86</sup>

Where the repudiating party has suffered foreseeable detriment or loss as a result of his reliance upon a notification or urging under [the relevant subsection], the aggrieved party,

- (a) shall not exercise his remedies under this section unless he first gives the repudiating party reasonable notice of his intention to do so; and
- (b) is liable to compensate the repudiating party for such foreseeable detriment or loss as he has suffered before the notice mentioned in clause (a).

Clause (a) corresponds with the well established duty of notification in cases of equitable estoppel;<sup>87</sup> clause (b) is more controversial and requires the aggrieved party to compensate the repudiating party for any foreseeable detriment or loss the repudiating party has suffered before receiving the notice.

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<sup>85</sup>Compare, *Bernstein v. Meech* (1891), 29 N.E. 255 (N.Y. Ct. App.), cited in NYLRC Study, ch. 5, footnote 52, *supra*, at p. (674) for the proposition that the aggrieved party may be estopped from denying liability to perform where he has led the repudiating party to believe that he would. To the same effect, see, *Restatement of the Law, Contracts 2d, Tent. Draft No. 8* (1973), sec. 280, Comment a, and Duesenberg and King, *Sales and Bulk Transfers Under the Uniform Commercial Code* (1972), sec. 14.06[2].

<sup>86</sup>See, Draft Bill, s. 8.10(3).

<sup>87</sup>*Tool Metal Mfg. Co. Ltd. v. Tungsten Electric Co. Ltd.*, [1955] 1 W.L.R. 761 (H.L.).

(iv) *Avoidance of Unjustifiable Expenditures and Duty To Mitigate*

As we have previously noted,<sup>88</sup> under existing Anglo-Canadian law the aggrieved party is not obliged to mitigate his damages unless he has accepted the repudiation. Indeed, in the light of *White and Carter (Councils) Ltd. v. McGregor*,<sup>89</sup> he may even be entitled to continue with his performance and incur further costs. The latter proposition was explicitly rejected, at least with regard to the seller, in section 64(4) of the *Uniform Sales Act*, which limited an aggrieved seller's damages for a repudiatory breach to those damages the seller would have suffered if he had done nothing towards carrying out the contract of sale after receiving notice of the buyer's repudiation. Pre-Code case law<sup>90</sup> was apparently a little more hesitant in imposing a blanket duty of mitigation on the aggrieved party. However, the equivalence of the position in the case of present and anticipatory breaches was clearly recognized in section 338 of the *Restatement of the Law of Contracts*.<sup>91</sup> The Code's counterpart to section 64(4) is UCC 2-704(2), which inverts the earlier rule and states the circumstances, in the case of a breach falling within UCC 2-703 and not just an anticipatory breach, in which "in the exercise of reasonable commercial judgment" and "for the purpose of avoiding loss" the seller may, *inter alia*, complete the manufacture of the goods or proceed in any other reasonable manner.<sup>92</sup> The negative implication, of course, is that, except in the circumstances indicated, the aggrieved party may not incur further expenditures, and the contrary reasoning in the *White and Carter* case is necessarily rejected.

In our view, the Code's approach is sound and we have concluded that it should be followed in the revised Act. We, therefore, recommend that the revised Act should contain a provision requiring the aggrieved party to mitigate his damages in the case of an anticipatory repudiation. However, as we have noted above, this obligation is expressed in very ambiguous language in UCC 2-610(a), and we have concluded that the ambiguity should be removed. We, therefore, recommend that the language of UCC 2-610(a) not be incorporated in the revised Act, but that the provision imposing an obligation to mitigate read as follows:<sup>93</sup>

The repudiating party is not liable in any event for loss or damage that the aggrieved party should have foreseen and could have mitigated or avoided without undue risk, expense or prejudice.

This provision is substantially based on section 336(1) of the *Restatement of the Law of Contracts*, which addresses itself to the general duty

<sup>88</sup>*Supra*, at p. 532.

<sup>89</sup>[1962] A.C. 413 (H.L. (Sc.)).

<sup>90</sup>See, *Williston on Sales* (Rev. ed., 1948), sec. 588.

<sup>91</sup>*Restatement of the Law of Contracts* (1932), sec. 338. "The rules for determining the damages recoverable for an anticipatory breach are the same as in the case of a breach at the time fixed for performance"; the *Restatement* provisions on mitigation of damages appear in section 336.

<sup>92</sup>This too appears to embody pre-Code law. See, *Williston on Sales* (Rev. ed., 1948), sec. 589.

<sup>93</sup>See, Draft Bill, s. 8.10(4).

of mitigation in breaches of contract. We have modified its language to make it more appropriate to its new setting.

We also recommend that the revised Act should include a section, similar to UCC 2-704, to the effect that where goods are unfinished at the time of a breach, the seller must exercise reasonable commercial judgment for the purposes of effective realization and avoidance of loss. The section should further provide that to these ends the seller may complete the manufacture and wholly identify the goods to the contract, or cease manufacture and resell for scrap or salvage value, or proceed in any other reasonable manner. This section should also apply to anticipatory breaches.<sup>94</sup>

#### (v) *Measurement of Damages*

We turn now to what has been termed "the most grizzly interpretative problem in Article Two".<sup>95</sup> The common law rule, both Anglo-Canadian<sup>96</sup> and American,<sup>97</sup> is that the aggrieved party's damages are to be assessed as at the time fixed for performance, subject to considerations of mitigation of loss, and not as at the date of repudiation. This rule has recently been reaffirmed by the Privy Council.<sup>98</sup> However, a difficulty arises under Article 2 because of the language of UCC 2-713, the section dealing with the buyer's damages for non-delivery or repudiation. As indicated earlier,<sup>99</sup> UCC 2-713(1), provides that the measure of damages is the difference between the market price and the contract price "at the time when the buyer learned of the breach". Since the subsection expressly refers to the seller's repudiation of the contract, it seems to suggest that the American common law test governing the time for determining the market price in the case of anticipatory repudiation has been changed fundamentally, from the date of stipulated performance to the date "when the buyer learned of the breach"; that is, the date of repudiation. However, it has been argued persuasively that UCC 2-713(1) should not be taken at face value and that the "learning" date should only be applied to a seller's performance breach and not to a breach by anticipatory repudiation.<sup>100</sup> So far, the issue appears to have been considered directly in only one reported

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<sup>94</sup>See, Draft Bill, s. 9.5 and s. 8.10(1)(c).

<sup>95</sup>White & Summers, *Handbook of the Law Under the Uniform Commercial Code* (1972), p. 197. See, also, Jackson, "'Anticipatory Repudiation' and the Temporal Element of Contract Law: An Economic Inquiry into Contract Damages in Cases of Prospective Non-Performance" (1978), 31 Stanford L. Rev. 69.

<sup>96</sup>*Tai Hing Cotton Mill Ltd. v. Kamsing Knitting Factory*, [1978] 2 W.L.R. 62, [1978] 1 All E.R. 515 (P.C.) and earlier authorities there cited.

<sup>97</sup>*Williston on Sales* (Rev. ed., 1948), sec. 587. However, the rule was not inflexible and exceptions were recognized for commodities for which there was an established market for long term contracts and for certain types of insurance contracts. *Ibid.*, Vol. 3, pp. 264-65, citing, *inter alia*, *Roehm v. Horst* (1899), 178 U.S. 1, a leading case on anticipatory breach.

<sup>98</sup>*Tai Hing Cotton Mill Ltd. v. Kamsing Knitting Factory*, [1978] 2 W.L.R. 62, [1978] 1 All E.R. 515 (P.C.).

<sup>99</sup>*Supra*, sec. 2.

<sup>100</sup>White & Summers, *Handbook of the Law Under the Uniform Commercial Code* (1972), pp. 196-202.

decision, *Oloffson v. Coomer*.<sup>101</sup> Here the Illinois Appellate Court apparently held that the time for determination of the market price was the date when the buyer learned of the seller's repudiation. However, the Court also found that the buyer was under a duty to mitigate his damages and that he had not acted in good faith. Moreover, the Court did not refer to the constructional difficulties presented by UCC 2-713(1). The decision cannot, therefore, be regarded as conclusive on the point.

It seems obvious that the ambiguity in UCC 2-713(1) as to the time with reference to which the damages of the aggrieved party should be assessed in the case of anticipatory repudiation, should be avoided in the revised Ontario Act. Accordingly, our recommended provisions dealing, respectively, with the *prima facie* measure of damages where the buyer wrongfully neglects or refuses to accept and pay for the goods,<sup>102</sup> and, in the converse situation, where the seller is in default<sup>103</sup> make it clear that the measure of damages there specified only applies to performance breaches and not to anticipatory breaches. Our Draft Bill contains no separate rule governing the time for measuring damages in cases of anticipatory breach. As a result, the existing common law rule will continue to apply; that is, that damages are to be assessed as at the time performance is due. This rule will, however, be subject to our earlier recommendations imposing upon an aggrieved party a duty of mitigation, even though under existing law the aggrieved party would not be under such a duty if he had not accepted the repudiation.

We recognize that the difference between the "learning" test in UCC 2-713(1) and the combined effect of the common law rule and our proposed duty to mitigate will often be a modest one. In many cases, a court might reasonably conclude that the duty to mitigate would, indeed, require that a victim of anticipatory repudiation cover or resell the goods at the time when he learned of the repudiation. It is only in situations where it is reasonable for the innocent party to take no immediate action that there will be a significant difference.

A literal application of UCC 2-713(1) requires that the aggrieved party's damages be measured by the market price prevailing at the time when he learned of the breach, whether or not it was reasonable to require him to take immediate measures to reduce his loss. By contrast, our proposal allows the aggrieved party greater leeway, and puts the onus on the repudiating party to show that an aggrieved party acting reasonably would have covered his loss more promptly. We think this difference between our rule and that found in UCC 2-713(1) is justifiable, because an anticipatory breach is not identical with breach of a present performance obligation. This fact is recognized in other provisions of both Article 2

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<sup>101</sup>*Oloffson v. Coomer* (1973), 296 N.E. 2d 871 (Ill. App. Ct.). The issue would also have been relevant but was not adverted to by the courts in *Fredonia Broadcasting Corp. v. RCA Corp.* (1973), 12 U.C.C. Rep. Serv. 1088 (5th Cir.) and *Sawyer Farmers Cooperative Assoc. v. Linke* (1975), 17 U.C.C. Rep. Serv. 102 (N.D.S.C.).

<sup>102</sup>See, Draft Bill, s. 9.10(3).

<sup>103</sup>See, Draft Bill, s. 9.16(3).

and our Draft Bill, insofar as these provisions permit the aggrieved party to continue to urge retraction without putting him to his election and foreclosing his options.<sup>104</sup>

Moreover, the fact that we do not impose a measure of damages assessed rigidly with reference to the time when the innocent party learned of the repudiation may also benefit the repudiating party: it may reduce the amount of his liability to the innocent party in situations where the price of the goods is subject to wide fluctuations and an aggrieved party acting prudently would not have gone immediately into the market to resell or make a covering purchase, as the case may be. We recognize, however, that a delay may work to the repudiating party's disadvantage where the price of the goods has risen rather than dropped.

It should be understood, however, that a seller who has actually resold or a buyer who has actually covered will be entitled to rely on the results of his resale or cover in cases of anticipatory breach in the same way as if the repudiating party's breach involved breach of a present obligation, and not an anticipatory breach of a future obligation.<sup>105</sup>

## 5. INSTALMENT CONTRACTS

The terms of a contract may often require or authorize the seller to make delivery by instalments. In the alternative, the buyer may have the option of requiring delivery to be made by instalments. It has long been recognized that some separate rules may be desirable to govern this type of contract.<sup>106</sup> Before the appropriateness of such rules can be determined, however, it is necessary to consider the meaning of the phrase "instalment contract".

### (a) MEANING OF "INSTALMENT CONTRACT"

It has been pointed out<sup>107</sup> that the present law relating to "instalment contracts" is based upon two sets of common law distinctions, and upon section 30 of the present Ontario Sale of Goods Act.

The first of the common law distinctions is that between an entire and a divisible contract. An instalment contract that is entire is, for many purposes, although not all, the same as a contract for the delivery of goods in one lot. The instalments are treated as though they were notionally lumped together in a single delivery. A divisible instalment contract, by contrast, is one in which a single instalment sometimes can be isolated from the rest of the contract. In such a case, a breach of the obligation to deliver or pay for a particular instalment may, in some cases, have no effect on the enforceability of the contract as it relates to the remainder of the instalments.

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<sup>104</sup>UCC 2-610(b) and, see, Draft Bill, s. 8.10(2).

<sup>105</sup>See, Draft Bill, ss. 9.9(1) and 9.15(1).

<sup>106</sup>For a general discussion of the topic of instalment contracts, see Carr, "Instalment Contracts", Research Paper No. III.7, and Williams, "Partial Performance of Entire Contracts" (1941), 57 L.Q.R. 373, 490.

<sup>107</sup>Carr, footnote 106 *supra*, at pp. 1-3.

The second common law distinction builds upon the first. Assuming that a given instalment contract is divisible, rather than entire, and assuming that a breach in relation to a particular instalment occurs, some distinction has to be made between situations in which the breach will be confined in its consequences to the obligations under the particular instalment, and those where the breach will have consequences extending to the obligations of the parties in respect of all the other instalments. The former variety of breach is known as a severable breach, and the latter as a non-severable breach.

The only express reference to instalment contracts in the present Sale of Goods Act may be found in the two subsections of section 30, which provide as follows:

30.(1) Unless otherwise agreed, the buyer of goods is not bound to accept delivery thereof by instalments.

(2) Where there is a contract for the sale of goods to be delivered by stated instalments that are to be separately paid for and the seller makes defective deliveries in respect of one or more instalments or fails to deliver one or more instalments or the buyer neglects or refuses to take delivery of or pay for one or more instalments, it is a question in each case depending on the terms of the contract and the circumstances of the case whether the breach of contract is a repudiation of the whole contract or whether it is a severable breach giving rise to a claim for compensation but not to a right to treat the whole contract as repudiated.

A problem common to both subsections is the lack of any definition of "instalment" in *The Sale of Goods Act*. As will appear from the subsequent discussion, there are several different types of arrangement that could arguably be considered to involve "instalments". The resulting uncertainty as to the scope of section 30 may pose problems both for the parties to the different kinds of contract, and for courts that are obliged to consider the relevance of section 30 to such contracts.

The scope of the two subsections is otherwise quite different, however. On the one hand, subsection (1) merely lays down the familiar rule that, unless otherwise agreed, the buyer is not obliged to accept delivery by instalments.<sup>108</sup> The subsection is only concerned with the mode of delivery, but it apparently applies to every type of delivery by "instalments", whatever the details of the underlying contract may be. On the other hand, subsection (2) is narrowly restricted in its application to those instalment contracts in which the instalments are expressly specified in the contract, and in which the buyer is obliged to pay for each instalment separately. The subsection focuses upon the nature of the remedies that should be available for breach of this narrow range of instalment contracts. In our view, the subject matter of the two subsections is so different that it is confusing to lump them together under the common heading of "instalment contracts". We therefore recommend that in the

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<sup>108</sup>See, Draft Bill, s. 5.5.

revised Act, as in the *Uniform Commercial Code*,<sup>109</sup> the provision comparable to section 30(1) should constitute a separate section that is wholly severed from the question of remedies for breach of a true instalment contract.

Subsection (2) appears to assume the existence of a divisible contract; the words "stated instalments that are to be separately paid for" seem designed to establish this, although it may be doubted that this is the correct test for such a contract. The subsection then leaves the question of whether a particular breach of such a contract is severable or non-severable to be determined in the light of all the circumstances. This latter provision has the merit of flexibility, but gives rise to considerable uncertainty, since it provides no standards designed to assist the parties to predict the consequences of a particular breach.

It might be thought that, if the narrow requirements of section 30(2) are not wholly satisfied, the other general provisions of *The Sale of Goods Act* would apply to determine the consequences of breaches of contract relating to multiple deliveries. It seems clear, however, that the common law on instalment contracts still applies to such a case, rather than the other provisions of *The Sale of Goods Act* relating to remedies.<sup>110</sup>

The key question is, therefore, whether the scope of any provision in our revised Act dealing with the remedies available for breach of an instalment contract should be expanded to apply to some or all of those contracts calling for multiple deliveries that lie outside the scope of section 30(2), and that are therefore governed by the common law. To help answer this question several types of arrangement that might arguably be considered to be "instalment contracts" should be considered.

The first such arrangement is not really a single contract at all, but is, rather, a series of contracts that are, in substance, separate agreements, and that are included in the same writing or verbal order for purposes of convenience. An example of this type of arrangement might be requests for items selected from a mail order catalogue.<sup>111</sup> There are two reasons why the present section 30(2) of *The Sale of Goods Act* does not apply to such an arrangement. One is that the subsection is restricted to instalments to be delivered under "a contract", a term that presumably means a single contract, while in the case under discussion there are multiple contracts. The other is that the parties will not have framed their agreement in terms of "stated instalments", since each item is perceived as a separate order. As a result, a non-conforming tender of one item will not *prima facie* entitle the buyer to refuse delivery of the other items, however serious the non-

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<sup>109</sup>UCC 2-307.

<sup>110</sup>See, *Jackson v. Rotax Motor Co.*, [1910] 2 K.B. 937 (C.A.), and *H. Longbottom & Co. Ltd. v. Bass Walker & Co.*, [1922] W.N. 245 (C.A.), *per* Atkin, L.J.

<sup>111</sup>Compare, *Williston on Sales* (Rev. ed., 1948), sec. 466a, p. 757.

conformity.<sup>112</sup> The result would be the same at common law,<sup>113</sup> and is defensible, if it is clear that there are, in substance, separate contracts for each item.<sup>114</sup>

The second type of arrangement involves the delivery of goods whose various components amount to a functional whole: for example, the parts of a machine or the pages of a manuscript. If no separate price is set or payable for the several parts or components, then the contract should be treated as entire and indivisible. In such a case neither section 30(2) nor the common law dealing with severable instalments will apply. If a separate price is payable there *may* be a divisible contract, but it would require strong evidence that this truly reflected the parties' intention. With regard to section 30(2), in particular, even if this latter hurdle could be overcome, there would still be the difficulty of accommodating the facts within section 30(2). In other words, it would be necessary that the goods be delivered in "stated" instalments, and that the separate payments relate to the particular instalments thus specified.

The third arrangement occurs where there is but one contract, covering different types of goods, and the items are to be delivered at different times and separately paid for. This type of contract appears to be divisible, and to be the type of contract where it might be proper to sever a breach of a single instalment from the rest of the contract. Nevertheless, it is far from clear that section 30(2) would apply. As mentioned earlier, the term "instalment" is not defined in the Act, with the result that it is uncertain whether the section would be restricted to the situation where the instalments are made up of like goods, or extended to multiple deliveries of different goods under a single contract. Moreover, the reported cases dealing with instalment contracts,<sup>115</sup> both before and after 1893, all appear to have dealt with contracts that involved goods that were all of the same kind. In principle, however, given that the underlying purpose of section 30(2) and the common law is to adapt the remedy that should be available for breach of one of a series of deliveries to the realities of the particular contract, there would seem to be no reason why the statute or the existing

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<sup>112</sup>By contrast, under UCC 2-609, such a breach with respect to delivery under one contract might give rise to "reasonable grounds for insecurity", so that the buyer might be able to demand adequate assurances of performance even with regard to contracts that are entirely separate and distinct from the contract which was breached, although there had not yet been a breach under those contracts, because delivery was scheduled for a later date. See discussion of this point, *supra*, this ch., sec. 3. We have recommended the adoption of a similar provision, which may be found in section 8.9 of our Draft Bill.

<sup>113</sup>See, *Benjamin's Sale of Goods* (1974), para. 647.

<sup>114</sup>As Williston, footnote 111 *supra*, points out, the fact that the goods are of a different kind and are individually priced is not conclusive. In his opinion (*ibid.*, p. 762) the test of whether the transaction constitutes several contracts is "whether the parties assented to all the promises as a single whole, so that there would have been no bargain whatever, if any promise or set of promises were struck out".

<sup>115</sup>For example, see, *Hoare v. Rennie* (1859), 5 H. & N. 19, 157 E.R. 1083 (Exch.); *Simpson v. Crippin* (1872), L.R. 8 Q.B. 14; *Honck v. Muller* (1881), 7 Q.B.D. 92 (C.A.); *Maple Flock Co. Ltd. v. Universal Furniture Products (Wembley) Ltd.*, [1934] 1 K.B. 148 (C.A.).

case law, as the case may be, should not also apply where the goods are not all of the same kind.

The fourth type of arrangement is that which Chalmers presumably had in mind when he first drafted the U.K. equivalent of section 30(2) in 1893.<sup>116</sup> For example, let us suppose that there is a contract for the sale of goods that are all of the same kind, such as 100,000 bushels of wheat, to be paid for and delivered in five instalments. This is clearly a divisible contract, and one defective delivery should not automatically give rise to a right to cancel the whole contract. Nevertheless, even this prototype situation may fall outside the literal scope of section 30(2). This might be the case, for example, if deliveries were not to be made by "stated instalments" specified in the contract, but rather at the option of either party, or if each instalment were not to be paid for separately, but on some other basis. The pre-1893 case law was not narrowly restricted in this manner, and the present day common law applies the same remedial rules as are found in section 30(2) to this kind of contract, when it falls outside the narrow scope of that subsection.<sup>117</sup> Nevertheless, it seems desirable that the statutory language should be brought into closer alignment with the jurisprudence and present day instalment transactions.

It may be concluded, therefore, that the provisions of the present Sale of Goods Act dealing with instalment contracts are unsatisfactory in a number of respects. We have noted already the problems that may arise under both subsections of section 30 because of the failure of the Act to define the word "instalment", and because of the narrow scope of the remedial provisions of subsection (2), with its requirements of "stated instalments" and separate payments. It has been argued further that the nineteenth century distinction between entire and divisible contracts, upon which both section 30(2) and the common law are based, is itself unsatisfactory. It has been suggested that the use of such an *a priori* test is inappropriate, and that, instead, the propriety of allowing termination of a whole contract for breach of a single instalment should be determined by an examination of the surrounding circumstances.<sup>118</sup>

By contrast, the *Uniform Commercial Code* does contain a definition of "instalment contract". That definition may be found in UCC 2-612(1), which provides as follows:

2-612.(1) An 'installment contract' is one which requires or authorizes the delivery of goods in separate lots to be separately accepted, even though the contract contains a clause 'each delivery is a separate contract' or its equivalent.

The section does not expressly state that the goods to be delivered "in separate lots" may be of unlike kinds; but neither is there a specification

<sup>116</sup>56 & 57 Vict., c. 7 (U.K.), s. 31(2). The wording of the two sections is not identical. For example, the Ontario provision expressly covers the situation where no delivery of an instalment takes place, while the U.K. subsection refers only to defective deliveries.

<sup>117</sup>See, Benjamin, footnote 113 *supra*, para. 649, and the cases there cited in n. 83.

<sup>118</sup>Carr, footnote 106 *supra*, at pp. 14-16.

that the separate deliveries must involve fungibles or goods of the same type.<sup>119</sup> The definition of "lot", which is found in UCC 2-105(5), is not particularly helpful. It merely states that "lot" means "a parcel or a single article which is the subject matter of a separate sale or delivery, whether or not it is sufficient to perform the contract". There is no clear indication of the meaning of the word "parcel", or specification whether the parcels or single articles that may be the subject of separate deliveries may be of unlike kinds. For this reason, coupled with the fact that the absence of a definition has not created difficulties under the existing Act, we have not adopted this, or any other, definition of "lot" in our Draft Bill. Despite the absence of any express reference to instalments made up of dissimilar goods, however, the language of UCC 2-612(1) appears sufficiently flexible that it could be applied to a contract calling for multiple deliveries of different types of goods, where the nature of the agreement and the underlying circumstances make this appropriate.

One advantage of UCC 2-612(1) over section 30(2) of *The Sale of Goods Act* is that it is clearly not restricted to situations where there are stated instalments or specific apportionments of the price. This is desirable, since the remedial problems relating to separate deliveries are not restricted to contracts with this degree of specificity. Instead, UCC 2-612(1) focuses upon separate acceptances of separate deliveries as the crucial test for application of the "instalment contract" provisions of the Code to a particular transaction. Moreover, as Official Comment 2 observes, "If separate acceptance of separate deliveries is contemplated, no generalized contrast between wholly 'entire' and wholly 'divisible' contracts has any standing under this Article". As a result, the *a priori* classification problems discussed above may be reduced or eliminated altogether. We believe that these advantages justify the incorporation of a similar provision in the revised Ontario Act. Accordingly, we recommend the adoption of a definition of instalment contract modelled upon that found in UCC 2-612(1).<sup>120</sup>

The latter part of UCC 2-612(1), which provides that a contract may be an instalment contract even though it contains a clause specifying that each delivery is a separate contract, is consistent with existing law. Anglo-Canadian courts have generally treated such clauses as manifesting a clear intention to enter into a divisible, as opposed to an entire, contract, but one that is nonetheless a single contract.<sup>121</sup> Since, however, the subsection refers to "an" instalment contract, it would, presumably, still be open to a court to hold that a particular document did incorporate a series of separate contracts, if this was its true substance.<sup>122</sup> The principle that the courts

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<sup>119</sup>So far as we have been able to ascertain there does not appear to be a reported case on the point.

<sup>120</sup>Compare, Draft Bill, s. 8.12(1).

<sup>121</sup>For the English judicial treatment of "each delivery is a separate contract" clauses, see, *Ross T. Smyth & Co. Ltd. v. T. D. Bailey Son & Co.*, [1940] 3 All E.R. 60 (H.L.), at p. 73, and see further, Benjamin, footnote 113 *supra*, para. 648.

<sup>122</sup>See the test proposed by Williston, as set out at footnote 114 *supra*; this standard for distinguishing between a series of separate contracts and an agreement that is in substance a single contract, notwithstanding separate deliveries, has been approved by Benjamin, footnote 113 *supra*, at para. 647.

should look to see whether, in fact, there is really a single agreement for multiple deliveries, even in the face of a clause stating that there are separate contracts, appears to us, however, to be sound. We therefore recommend that a provision that a contract may be an instalment contract even though it contains a clause to the effect that each delivery is a separate contract be incorporated in the revised Ontario Act.<sup>123</sup>

(b) BREACH OF INSTALMENT CONTRACT BY SELLER

Three problems will be considered under this heading. First, what is the effect on the balance of the contract of the seller's breach with respect to one or more instalments, or, more specifically, when may the buyer cancel the contract because of such a breach? Secondly, if the buyer is entitled, and has elected, to treat breach of part of the contract as a breach of the whole, how does this affect the position of previously delivered and conforming instalments? Thirdly, what are the buyer's rights of rejection with respect to a particular defective instalment, taken by itself?

(i) *Effect of Breach As To Instalment Upon The Balance of The Contract*

Section 30(2) of the present Sale of Goods Act provides no clear standard for the determination of the effect of a particular breach of one or more instalments upon the contract as a whole. The subsection merely indicates that "it is a question in each case depending on the terms of the contract and the circumstances of the case whether the breach of contract is a repudiation of the whole contract or whether it is a severable breach giving rise to a claim for compensation but not to a right to treat the whole contract as repudiated". The vagueness of the statutory language reflects the uncertain and, to some extent, conflicting criteria adopted in the pre-1893 case law.<sup>124</sup> It is now generally accepted that the appropriate modern tests for determining whether a particular breach of an instalment gives the buyer a right to cancel the whole contract are those set forth in the decision of the English Court of Appeal in *Maple Flock Co. Ltd. v. Universal Furniture Products (Wembley) Ltd.*<sup>125</sup> These criteria were "first, the ratio quantitatively which the breach bears to the contract as a whole, and secondly the degree of probability or improbability that such a breach will be repeated".<sup>126</sup>

Section 45(2) of the *Uniform Sales Act* determined the consequences of a breach of a particular instalment in terms of the materiality of the breach; the test in the subsection is "whether the breach of contract is so material as to justify the injured party in refusing to proceed further and suing for damages for breach of the entire contract, or whether the breach is severable".<sup>127</sup> It has been indicated that the proper test for materiality is

<sup>123</sup>See, Draft Bill, s. 8.12(1).

<sup>124</sup>Compare, *Hoare v. Rennie* (1859), 5 H. & N. 19, 157 E.R. 1083 (Exch.); *Simpson v. Crippin* (1872), L.R. 8 Q.B. 14; *Honck v. Muller* (1881), 7 Q.B.D. 92 (C.A.).

<sup>125</sup>[1934] 1 K.B. 148 (C.A.).

<sup>126</sup>*Ibid.*, at p. 157.

<sup>127</sup>*Uniform Sales Act*, s. 45(2).

“whether the default is so substantial and important as in truth and in fairness to defeat the essential purpose of the parties”.<sup>128</sup>

Apparently the departure of section 45(2) of the *Uniform Sales Act* from the references to repudiation in *The Sale of Goods Act*, and the substitution of the objective test of materiality, reflected a conscious policy decision by the author of the *Uniform Sales Act*.<sup>129</sup> This test is open to objection, however, on the ground that it does not expressly provide for the situation where the immediate breach is not, in and of itself, a material breach, but manifests a subjective intent on the part of the wrongdoer to repudiate the balance of the contract. By contrast, it could be argued that the repudiatory language of *The Sale of Goods Act* might be narrowly construed, so that a serious breach which did not manifest an unwillingness to perform, and hence was not a repudiation, would not come within the “instalment” provisions of section 30(2). In fact, however, the subsection has not been construed this narrowly.<sup>130</sup>

The *Uniform Commercial Code* also retains the materiality concept, but expresses it in terms of an “impairment of value”. UCC 2-612(3) reads as follows:

2-612.(3) Whenever non-conformity or default with respect to one or more installments substantially impairs the value of the whole contract there is a breach of the whole. But the aggrieved party reinstates the contract if he accepts a non-conforming installment without seasonably notifying of cancellation or if he brings an action with respect only to past installments or demands performance as to future installments.

In our view this test is an improvement on the materiality test because it clearly focuses attention on the effect of the breach, rather than the breach itself. It also expressly requires that the seriousness of the breach be evaluated in terms of its effect upon the contract as a whole, instead of with respect to the particular instalment, and establishes a clear standard for evaluating the seriousness of such an effect. Moreover, it resembles the test of substantial breach that we have recommended for adoption in the revised Act.<sup>131</sup> We therefore favour the adoption of the Code standard for determining when breach with regard to an instalment will amount to a breach of the whole contract, subject to the insertion of a requirement that the substantial impairment be foreseeable, in order to achieve consistency with our general definition of substantial breach.<sup>132</sup> Accordingly, we recommend that the revised Act should provide that, if a non-conformity or breach with respect to one or more instalments substantially and foreseeably impairs

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<sup>128</sup>*Helgar Corp. v. Warner's Features* (1918), 222 N.Y. 449 at pp. 453-54, (1918), 119 N.E. 113 at p. 114.

<sup>129</sup>Williston, footnote 111 *supra*, secs. 467a, 467b.

<sup>130</sup>For a more detailed discussion of these problems, see Carr, footnote 106 *supra*, at pp. 19-21.

<sup>131</sup>See, Draft Bill, s. 1.1(1)24, and ss. 8.1, 8.10, 9.3(2), 9.12(2), *et al.*

<sup>132</sup>Compare, Draft Bill, s. 1.1(1)24.

the value of the whole contract to the other party, there is a substantial breach of the whole contract.<sup>133</sup>

It will be noted that, like the *Uniform Sales Act*, the *Uniform Commercial Code* test makes no reference to the guilty party's state of mind. It is unlikely, however, that this omission would adversely affect an innocent party. UCC 2-610, which deals with anticipatory repudiation, provides an alternative ground for excusing the innocent party from further obligations, where the breach with regard to the present instalment provides evidence that the guilty party intends to repudiate his obligation to make future deliveries as well. This remedy would presumably be available even if the immediate breach does not meet the "substantial impairment" test under UCC 2-612(3), if the loss of the future performance would amount to a substantial impairment under UCC 2-610. We believe that the combined effect of our proposed provisions dealing with instalment contracts and anticipatory repudiation would achieve the same result.<sup>134</sup>

(ii) *Effect of Breach of The Whole Contract On  
Previously Accepted Instalments*

Under this heading, two separate questions must be considered.<sup>135</sup> The first is whether the buyer must be in a position to return any previously accepted instalments as a condition of his right to cancel the contract because of a subsequent breach. The second question is whether the buyer is *entitled* to return any previously accepted instalments if he elects to do so.

The first question is much easier to answer than the second. The buyer's right to cancel is not dependent on his ability to return previous instalments. This position can be justified by analogy to section 29(3) of the Ontario Sale of Goods Act. This subsection entitles the buyer to reject goods that do not conform to the contract description that have formed part of a single delivery, while retaining those goods that are conforming. More simply, this result can be justified on the basis that it is inherent in the concept of a divisible contract. Both *The Sale of Goods Act* and the *Uniform Commercial Code* appear to assume implicitly that this is the position, and no contrary case law has appeared since 1893. This point would not appear, therefore, to call for specific treatment in the revised Act.

The second question is much more difficult. At first glance, it might be thought that, if the contract is divisible, it should no more be possible for the buyer to force previously accepted instalments back on the seller than it should be possible for the seller to insist on complete rescission. The meagre case law appears to support this proposition.<sup>136</sup> To the extent that

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<sup>133</sup>See, Draft Bill, s. 8.12(3).

<sup>134</sup>Compare, Draft Bill, ss. 8.12(3) and 8.10(1).

<sup>135</sup>Compare, Carr, footnote 106 *supra*, pp. 46 *et seq.*

<sup>136</sup>*Brandt v. Lawrence* (1876), 1 Q.B.D. 344 (C.A.); *Tarling v. O'Riordan* (1878), 2 L.R. Ir. 82 (C.A.), and see further, Carr, footnote 106 *supra*, pp. 49-57.

they discuss the problem at all, textwriters appear to be divided in their views,<sup>137</sup> and neither the Ontario Sale of Goods Act nor Article 2 of the *Uniform Commercial Code* addresses itself directly to the issue.

The position is complicated because discussions of this question do not always observe the distinction between entire and divisible contracts.<sup>138</sup> If the manufacturer of a machine delivers part of it and then repudiates, it can be persuasively argued that the buyer should be able to revoke his "acceptance" of the part that has already been delivered. This conclusion rests, however, on the assumption that the machine constitutes a single functional unit and that the contract was indivisible.<sup>139</sup> There was, in reality, no true "acceptance" of the part; at best there was only a conditional acceptance, dependent upon satisfactory performance of the balance of the contract. This example throws little light on what the rule should be where the instalment that has been delivered and accepted constitutes a commercial unit in its own right.

We appreciate these difficulties. On balance, however, the Commission has concluded that the equities favour the buyer. If the seller's breach is of such a substantial character that it impairs the value of the whole contract to the buyer, then it does not seem unreasonable to allow the buyer to revoke his acceptance of any previously delivered instalments, and we so recommend. However, we also recommend that, as in other cases of revocation, revocation of acceptance of such instalments should only be permitted in the following circumstances: if it occurs within a reasonable time after the buyer discovers or should have discovered the ground for revocation; if there has been no substantial change in the condition of the goods which is not caused by their own defects or by casualty suffered by them while at the seller's risk; and, if notification of the revocation is given to the seller.<sup>140</sup>

<sup>137</sup>Atiyah, *The Sale of Goods* (5th ed., 1975), p. 286, seems to imply that the buyer may have the right to return previous instalments, since he accepts at face value the language of section 30(2) that the breach of contract may amount to "a repudiation of the *whole* contract" (*italics added*). This rendering is inconsistent with the cases cited in footnote 136 *supra*. Benjamin, footnote 113 *supra*, para. 653, implicitly rejects the buyer's right to return previous instalments though he cautiously recognizes that "if the instalments already delivered can be regarded as parts of an indivisible whole, e.g., individual volumes of a set of books, parts of a machine, or a suit of clothes, then the buyer will be entitled to rescind the contract *ab initio* by returning the instalments already delivered . . .". Note 9 to this text qualifies the textual statement by adding, "It could, however, be argued that, by making the contract divisible, the buyer could rescind only as to future instalments". Williston, footnote 111 *supra*, sec. 467, accepts the thesis that the seller's total breach should entitle the buyer to rescind the contract *ab initio*, though he admits that not all the principles stated by him are "undisputed". He bases his position on the provision analogous to section 29 of the Ontario Sale of Goods Act, but *quaere* the soundness of the analogy.

<sup>138</sup>This is perhaps true of the examples cited in Benjamin in footnote 137 *supra*.

<sup>139</sup>Compare 1977 draft UNCITRAL Convention, Art. 50(3):

A buyer, avoiding the contract in respect of any delivery, may, at the same time, declare the contract avoided in respect of deliveries already made or of future deliveries if, by reason of their interdependence, those deliveries could not be used for the purpose contemplated by the parties at the time of the conclusion of the contract.

<sup>140</sup>See, Draft Bill, s. 8.12(4).

(iii) *Breach With Respect To A Single Instalment*

The existing Sale of Goods Act does not state clearly the buyer's right with respect to a single defective instalment, where breach of the instalment does not amount to a breach of the whole contract, or where the buyer does not elect to treat it as such. In principle, however, the buyer's remedies with regard to that specific instalment should be no different from those that would have been available to him if there had been a breach of an entire contract calling for a single delivery of those same goods;<sup>141</sup> that is, he should have the right to reject the goods or claim damages or both, if the breach amounts to a breach of a condition, and he should be restricted to a claim in damages if the breach only involves breach of a warranty.

A difficulty arises because section 30(2) of *The Sale of Goods Act*, in discussing the consequences of a defective delivery, speaks of a severable breach "giving rise to a claim for compensation<sup>[142]</sup> but not to a right to treat the whole contract as repudiated". This suggests that the buyer in such cases is limited to a claim for compensation and that he has no right to reject. Textwriters appear to agree, however, that this is not a correct inference.<sup>143</sup> If a provision similar to section 30(2) were to be retained in the revised Act, it would seem desirable to place this question beyond doubt by expressly giving the buyer a right to reject; we do not, however, recommend the retention of the subsection.

The *Uniform Commercial Code* provisions are also not free from difficulty. UCC 2-612(2) provides:

2-612.(2) The buyer may reject any installment which is non-conforming if the non-conformity substantially impairs the value of that installment and cannot be cured or if the non-conformity is a defect in the required documents; but if the non-conformity does not fall within subsection (3) and the seller gives adequate assurance of its cure the buyer must accept that installment.

It should be noted that the buyer's right to reject under this subsection is not governed by the same criteria that apply to breach of a non-instalment contract. In the latter case, UCC 2-601 permits the buyer to reject if the goods are non-conforming "in any respect". In an instalment contract, on the other hand, in order to reject the buyer must be able to show a substantial impairment in value of the defective instalment, and, it would seem, that the defect cannot be cured. An exception is made in the case of a defect in the required documents, where the special substantial impairment and cure requirements do not apply. The Official Comment to UCC 2-612 provides no explanation for the application of a different standard with respect to the buyer's right to reject a defective instalment and the separate treatment of defective documents.

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<sup>141</sup>Compare, Benjamin, footnote 113 *supra*, para. 655; Atiyah, footnote 137 *supra*, p. 286.

<sup>142</sup>The scope of this expression is explained in *Workman Clark & Co., Ltd. v. Lloyd Brazileño*, [1908] 1 K.B. 968 (C.A.), at pp. 978-79.

<sup>143</sup>See the authorities cited in footnote 141, *supra*.

The apparent imposition of a requirement that the defect not be curable as a condition of the buyer's right to reject is also inconsistent with the cure provisions in UCC 2-508(2). Under the latter subsection, the burden of offering cure falls on the seller. Moreover, the right to cure is not absolute, and it does not arise until after the buyer has rejected a tender as non-conforming. It may be that these discrepancies are only linguistic and that the draftsmen did not intend the cure provision to operate differently in the case of instalment contracts. However, the discrepancies are potentially of such a serious nature that it would be unwise to adopt UCC 2-612(2) in its present form in a revised Ontario Act.

We have previously recommended<sup>144</sup> the adoption of an integrated right to cure that would apply uniformly to non-conforming tenders or deliveries by the seller. If this recommendation is implemented it should be unnecessary for cure purposes to draw a distinction between breach of an instalment contract and other types of non-conforming tender. Instead, we recommend that a buyer's rights with regard to a non-conforming instalment should be the same as if the instalment were a separate contract.<sup>145</sup>

#### (c) BREACH OF INSTALMENT CONTRACT BY BUYER

In principle the buyer's breaches of an instalment contract should be treated in the same way as those of the seller and we so recommend. It is therefore unnecessary to retrace all of the same ground in our discussion of this topic. The provisions of section 30(2) of the present Sale of Goods Act, which deal with the question of whether a breach of a particular instalment amounts to a breach of the whole contract, are made expressly applicable to the situation where the buyer "neglects or refuses to take delivery of or pay for one or more instalments". Section 30(2) does not state clearly the seller's rights with regard to the particular instalment, where the buyer's wrongful conduct does not amount to a breach of the whole contract, or where the seller elects not to treat it as such; however, as was earlier noted,<sup>146</sup> the same is true with regard to the buyer's rights when the seller is in breach. In both cases general sales principles should be applied.

The position under the *Uniform Commercial Code* is more complicated. UCC 2-612 does not expressly refer to the buyer's breaches, but Comment 6 to the section clearly contemplates that UCC 2-612(3), which determines when a breach as to an instalment will amount to a breach of the whole contract, will be applied in such circumstances. This conclusion is supported by the reference to "aggrieved party" in the second sentence of subsection (3), since UCC 1-201(2) defines "aggrieved party" as "a party entitled to resort to a remedy", and this definition is broad enough to embrace both buyers and sellers.

We have concluded that the standard of substantial and foreseeable impairment of the value of the whole contract, which we have recommended should determine the situations in which a breach by a seller as to

<sup>144</sup>*Supra*, ch. 17, sec. C.(d)(ii)(1).

<sup>145</sup>See, Draft Bill, s. 8.12(2).

<sup>146</sup>*Supra*, this ch., sec. 5(b)(iii).

a particular instalment should justify cancellation of the whole contract by the buyer,<sup>147</sup> should also apply to such breaches by the buyer. We recommend that provision in the revised Act specifying the circumstances in which breach of a single instalment will amount to a substantial breach of the whole contract should be equally applicable to buyers and sellers.<sup>148</sup>

The position under the *Uniform Commercial Code* with respect to the impact of the breach upon the seller's rights with respect to the particular instalment is less clear. UCC 2-612(2) only deals with the buyer's right of rejection of the particular instalment where the seller is in default, with no reference to the seller's rights when it is the buyer who is in breach. This silence invites the inference that the buyer's breach is to be regulated by the principle of strict performance enshrined in UCC 2-703. If this conclusion is correct, the seller would be entitled to exercise all the rights with respect to the instalment to which he would have been entitled if the goods involved in the particular instalment had been delivered as a single delivery under a non-instalment contract. This would be true even though the breach was minor in scope and could be easily cured. On the other hand, as noted earlier,<sup>149</sup> the buyer would be able to reject the same instalment only if its defects substantially impaired the value of the instalment and they could not be cured, except where the non-conformity related to required documents. These differences appear illogical, and we believe that the same standard should be applied to breaches relating to particular instalments by both the buyer and the seller. We therefore recommend that the buyer and the seller should have the same rights with respect to a breach by the other party concerning a single instalment that they would have had if that instalment had been a separate contract, and our Draft Bill so provides.<sup>150</sup>

#### (d) REINSTATEMENT OF THE CONTRACT

UCC 2-612(3), after specifying the circumstances in which a breach with respect to a particular instalment amounts to a breach of the whole contract, continues:

... But the aggrieved party reinstates the contract if he accepts a non-conforming installment without seasonably notifying of cancellation or if he brings an action with respect only to past installments or demands performance as to future installments.

The first and third conditions of reinstatement set out in this provision, that is, acceptance of a non-conforming instalment or a demand for future performance, are unobjectionable. The second, however, is of doubtful merit. It is not obvious why a suit involving only a past instalment should be conclusively treated as a waiver of the right to cancel the whole contract. The obligation to give prompt notification of cancellation should provide adequate protection to the party in breach.

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<sup>147</sup>*Supra*, this ch., sec. 5(b)(i).

<sup>148</sup>See, Draft Bill, s. 8.12(3).

<sup>149</sup>*Supra*, this ch., sec. 5(b)(iii).

<sup>150</sup>See, Draft Bill, s. 8.12(2).

It has been suggested to us<sup>151</sup> that the reinstatement portion of UCC 2-612(3) is unnecessary, and that problems of waiver and election of remedies for breach of an instalment contract can safely be left to be determined in light of the general rules on this topic recommended for adoption in the revised Act,<sup>152</sup> or under general principles of law.<sup>153</sup> We agree with this suggestion, and recommend the revised Act should not include a provision comparable to the second sentence of UCC 2-612(3) specifying conditions of reinstatement of the whole contract.<sup>154</sup>

(e) CONCLUSION

In the light of the foregoing discussion, we recommend adoption of the following provisions on instalment contracts in the revised Ontario Act:

8.12.(1) In this Act "instalment contract" means a contract that requires or authorizes the delivery of goods in separate lots to be separately accepted, notwithstanding a provision in the contract to the effect that each delivery is a separate contract.

(2) Subject to subsection 3, the buyer's rights and remedies with respect to a non-conforming instalment and the seller's rights and remedies with respect to breach by the buyer of his obligations in relation to an instalment are the same with respect to that instalment as if it were a separate contract.

(3) If the non-conformity or breach with respect to one or more instalments substantially and foreseeably impairs the value of the whole contract to the other party, there is a substantial breach of the whole contract.

(4) Where there has been a substantial breach of the whole contract by the seller, the buyer may, subject to section 8.8(2) and (3), revoke his acceptance of any instalment previously received by him.

**RECOMMENDATIONS**

The Commission makes the following recommendations:

1. The revised Act should adopt a single test to determine the circumstances in which a breach of a contract will amount to a substantial breach. For this purpose, the following definition of "substantial breach" should be incorporated in the revised Act:

'substantial breach' means a breach of contract that the party in breach foresaw or ought reasonably to have foreseen as likely to impair substantially the value of the contract to the other party.

2. The revised Act should not contain a definition of the term "available market"; rather, the concept of an available market and other

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<sup>151</sup>Carr, footnote 106 *supra*, at p. 68.

<sup>152</sup>Compare, Draft Bill, ss. 4.8, 8.10, 8.11.

<sup>153</sup>See, Draft Bill, s. 3.4.

<sup>154</sup>Compare, Draft Bill, s. 8.12(3).

market price terminology should be abandoned. If, however, it is decided to retain the concept of "available market", the revised Act should adopt a provision comparable to UCC 2-723(2) as a means of establishing the market price at a relevant date where it cannot otherwise be ascertained.

3. The revised Act should adopt, in place of the market price test contained in sections 48(3) and 49(3) of the existing Sale of Goods Act, a test of commercially reasonable disposition or purchase. Accordingly, the revised Act should provide that,
  - (a) where the buyer wrongfully neglects or refuses to accept and pay for the goods at the agreed time for performance, and in circumstances amounting to a substantial breach, and the seller has not actually resold, the measure of the seller's damages should *prima facie* be ascertained by the difference between the contract price and the price that could have been obtained by a commercially reasonable disposition of the goods, less any expenses saved in consequence of the buyer's breach; and
  - (b) where the seller wrongfully neglects or refuses to deliver the goods at the agreed time for performance and in circumstances amounting to a substantial breach, or where the buyer rightfully rejects or revokes his acceptance of the goods, and the buyer has not actually covered, the measure of the buyer's damages should *prima facie* be ascertained by the difference between the contract price and the price at which the goods could have been obtained in a commercially reasonable purchase, less any expenses saved in consequence of the seller's breach.
4. For the purpose of measuring the aggrieved party's damages in accordance with the test of commercially reasonable disposition or purchase, the revised Act should contain a rule that the price that could have been obtained by a commercially reasonable disposition or purchase of the goods shall be the price obtaining at a reasonable place.
5. The revised Act should incorporate a test, in place of the test contained in sections 48(3) and 49(3) of the existing Sale of Goods Act, to the effect that the aggrieved party's damages should be determined with reference to the price at which the goods could have been resold or purchased, as the case may be, within a reasonable time after the aggrieved party learned of the breach by the other party.
6. A section comparable to UCC 2-609 entitling one party to demand adequate assurance of performance from the other party where reasonable grounds for insecurity arise should be enacted in the revised Act subject to the following modifications:
  - (i) The opening sentence of UCC 2-609(1) should not be incorporated in the comparable provision in the revised Act.

- (ii) A provision comparable to UCC 2-609(2) should not be included in the revised Act, and the word "commercially" in the phrase "commercially reasonable" should not be incorporated in the provision corresponding to UCC 2-609(1) in the revised Act.
  - (iii) The section should provide that, upon adequate assurance being provided, the aggrieved party's obligation to perform is restored, but that he is not liable for any delay occasioned by his suspension of performance.
7. The extent to which a contract may impose or permit standards deviating from those incorporated in the section dealing with adequate assurance of performance should be governed by the proposed general provision in the revised Act delineating the extent to which the parties are free to vary the provisions of the Act.
  8. The right to seek adequate assurance of performance should not be expressly restricted to cases where the person seeking adequate assurance of performance has not performed his obligations under the contract.
  9. The provision in the revised Act comparable to UCC 2-609, unlike UCC 2-611(3), should not confer upon the aggrieved party the right to an allowance for any delay occasioned by the aggrieved party's suspension of performance.
  10. Provisions comparable to UCC 2-610 and UCC 2-611 dealing with anticipatory repudiation should be incorporated in the revised Act, subject to recommendations 12 and 13(a), *infra*.
  11. There should be no definition of repudiation included in the revised Act.
  12. There should be a provision included in the section of the revised Act comparable to UCC 2-610 stipulating that, where the repudiating party has suffered foreseeable detriment or loss as a result of his reliance upon a notification by the aggrieved party that he would await performance by the repudiating party, or because the aggrieved party has urged the repudiating party to perform, the aggrieved party
    - (a) should not be able to exercise his remedies unless he first gives the repudiating party reasonable notice of his intention to do so; and
    - (b) should be liable to compensate the repudiating party for such foreseeable detriment or loss as he has suffered before the notice mentioned in clause (a).
  13. The revised Act should contain a provision requiring the aggrieved party to mitigate his damages in the case of an anticipatory repudiation. Accordingly, the revised Act should incorporate the following provisions:

- (a) a subsection modelled on section 336(1) of *Restatement of the Law of Contracts*, rather than UCC 2-610(a), stipulating that the repudiating party is not liable in any event for loss or damage that the aggrieved party should have foreseen and could have mitigated or avoided without undue risk, expense or prejudice;
  - (b) a section, similar to UCC 2-704, to the effect that, where goods are unfinished at the time of a breach, the seller must exercise reasonable commercial judgment for the purposes of effective realization and avoidance of loss, and to these ends the seller may complete the manufacture and wholly identify the goods to the contract, or cease manufacture and resell for scrap or salvage value, or proceed in any other reasonable manner.
14. No special provision should be adopted to determine the time for the measurement of damages in cases of anticipatory repudiation. The existing common law rule that the aggrieved party's damages are to be assessed as at the time fixed for performance should continue to apply, subject to recommendation No. 13, *supra*, imposing upon an aggrieved party a duty of mitigation.
  15. The provision in the revised Act comparable to section 30(1) of the present Sale of Goods Act, which specifies that the buyer is not obliged to accept delivery by instalments unless otherwise agreed, should constitute a separate section that is wholly severed from the section dealing with remedies for breach of an instalment contract.
  16. A definition of instalment contract modelled upon that found in UCC 2-612(1) should be adopted in the revised Ontario Act.
  17. The revised Act should provide that a contract may be an instalment contract even though it contains a clause to the effect that each delivery is a separate contract.
  18. With the exception of recommendation No. 20, *infra*, the same rules should govern breaches of instalment contracts by both buyers and sellers.
  19. The revised Act should provide that, if a non-conformity or breach with respect to one or more instalments substantially and foreseeably impairs the value of the whole contract to the other party, there is a substantial breach of the whole contract.
  20. The revised Act should provide that, if the seller's breach is of such a substantial character that it foreseeably impairs the value of the whole contract to the buyer, the buyer should be able to revoke his acceptance of any previously delivered instalments, but only in the following circumstances: if the revocation occurs within a reasonable time after the buyer discovers or should have discovered the ground for revocation; if there has been no substantial change in the condition of the goods which is not caused by their own defects or by casualty suffered by them while at the seller's risk; and, if notification of the revocation is given to the seller.

21. Both the buyer and the seller should have the same rights with respect to a breach by the other party concerning a single instalment that they would have had if that instalment had been a separate contract.
22. The revised Act should not include a provision comparable to the second sentence of UCC 2-612(3) specifying conditions of reinstatement of the whole contract.

## **PART VII**



We discuss in this chapter a number of issues that affect the general scope or operation of the revised Sale of Goods Act, the adoption of which we have previously recommended in this Report.

### 1. APPLICABILITY OF REVISED ACT TO CROWN

We recommend that the Crown should be bound by the proposed revised Sale of Goods Act, and our Draft Bill contains a provision to this effect.<sup>1</sup> Our recommendation is based on several grounds. First, we believe it right in principle that the Crown should be subject to the same rules of private law when entering the marketplace as is the citizen; the Crown should not be entitled, in the absence of strong policy reasons, to separate or preferential treatment.<sup>2</sup> We know of no such reasons that would apply in this branch of the law.

Our second reason is that recent or proposed Ontario legislation — such as *The Mechanics Lien Act*,<sup>3</sup> *The Blind Persons Rights Act, 1976*,<sup>4</sup> and the proposed revision to *The Limitations Act*<sup>5</sup> — indicates a trend in favour of binding the Crown. We understand that this legislation in turn reflects considered, and consistent, current government policy with respect to this aspect of the prerogatives of the Crown.

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<sup>1</sup>See, Draft Bill, s. 2.3.

<sup>2</sup>We recognize that there is some authority for the proposition that the Crown, by entering into a contract, cannot fetter its discretionary power to act for the public good, even if this involves a breach of the terms of a purported contract. An extreme expression of this doctrine is to be found in the much criticized judgment of Rowlatt, J., in *Rederiaktiebolaget Amphitrite v. The King*, [1921] 3 K.B. 500, 503-04; and compare. *The King v. Dominion of Canada Postage Stamp Vending Co. Ltd.*, [1930] S.C.R. 500, per Newcombe, J., at p. 506. See further, Hogg, *Liability of the Crown in Australia, New Zealand and the United Kingdom* (1971), pp. 129 *et seq.*; Williams, *Crown Proceedings* (1948), pp. 9-10; de Smith, *Judicial Review of Administrative Action* (3rd ed., 1973), p. 279; Waddams, *The Law of Contracts* (1977), pp. 402-03; and, *The Canadian Encyclopedic Digest (Ontario)* (3rd ed., 1975), Vol. 8, p. 40-79. There is, however, a remarkable paucity of authority on so important a question. Moreover, there is no consensus among scholars about the current position and, indeed, about whether there is, in fact, an established doctrine of executive necessity or discretion. Our own inquiries lead us to believe that the current practice of the Ontario Government is not to rely on such a doctrine, if, in fact, it exists. In the light of all these uncertainties we have not thought it necessary or prudent to create an express exception to the provision in the Draft Bill that binds the Crown for the purported doctrine of executive discretion. If, indeed, there is such a doctrine, it will be captured in the general residuary provision in s. 3.4 of the Draft Bill.

<sup>3</sup>R.S.O. 1970, c. 267, as am. by S.O. 1975, c. 43, s. 2.

<sup>4</sup>S.O. 1976 (2nd Sess.), c. 14, s. 1(3).

<sup>5</sup>R.S.O. 1970, c. 246. See, Ontario Law Reform Commission, *Report on Limitation of Actions* (1969), p. 137, and Ministry of the Attorney General, *Discussion Paper on Proposed Limitations Act* (Sept. 1977), "Discussion Draft of Proposed Act", s. 13.

Our third reason is that not to bind the Crown would invite much confusion in seeking to establish the applicable rules where the Crown is a party to a contract of sale. The Crown would apparently be bound by the common law rules of contract,<sup>6</sup> and, to the extent that the revised Sale of Goods Act, like its predecessor, merely codifies those rules in the sales area, there would be no change.<sup>7</sup> In many instances, however, our Draft Bill modifies or repeals a common law rule. In such cases, the parties would experience difficulties in determining the boundary between the binding and non-binding rules. We would regard this uncertainty as most undesirable.

## 2. LIMITATION PERIOD

The existing Sale of Goods Act contains no provisions governing the limitation period in actions arising out of a contract of sale; nor does *The Limitations Act*.<sup>8</sup> As a result, sales transactions are subject to the normal limitation period applicable to simple contracts; that is, six years from the time the cause of action arises.<sup>9</sup> The *Uniform Limitation of Actions Act* adopted by the Uniform Law Conference of Canada,<sup>10</sup> also contains no separate rules with respect to contracts of sale.

By way of contrast, UCC 2-725<sup>11</sup> establishes a four year limitation

<sup>68</sup> C.E.D. (Ont. 3d), footnote 2 *supra*, para. 148, at p. 40-84, and authorities there cited.

<sup>7</sup> Indeed, the proposition is advanced in 8 C.E.D. (Ont. 3d), footnote 2 *supra*, para. 149, at p. 40-84, that "[i]t would seem that, in determining the rights and liabilities under contracts with Her Majesty, provincial statutes forming part of the general law will bind Her Majesty, including Her Majesty in right of Canada, even though she is not mentioned therein." The authorities cited in support of this proposition are *Dominion Building Corp. v. R.*, [1933] A.C. 533 (P.C.), and *Bank of Nova Scotia v. The Queen* (1961), 27 D.L.R. (2d) 120 (Exch. Ct.). If this is a correct interpretation of the current position, then presumably a Sale of Goods Act, old or new, will bind the Crown even in the absence of an explicit provision to this effect. However, we believe it would be safer not to leave the question in doubt.

<sup>8</sup> R.S.O. 1970, c. 246.

<sup>9</sup> *Ibid.*, s. 45(g).

<sup>10</sup> *Consolidation of Uniform Acts of the Uniform Law Conference of Canada* (1978), pp. 29-1 *et seq.*, s. 2(1)(f)(i).

<sup>11</sup> UCC 2-725 reads as follows:

(1) An action for breach of any contract for sale must be commenced within four years after the cause of action has accrued. By the original agreement the parties may reduce the period of limitation to not less than one year but may not extend it.

(2) A cause of action accrues when the breach occurs, regardless of the aggrieved party's lack of knowledge of the breach. A breach of warranty occurs when tender of delivery is made, except that where a warranty explicitly extends to future performance of the goods and discovery of the breach must await the time of such performance the cause of action accrues when the breach is or should have been discovered.

(3) Where an action commenced within the time limited by subsection (1) is so terminated as to leave available a remedy by another action for the same breach such other action may be commenced after the expiration of the time limited and within six months after the termination of the first action unless the termination resulted from voluntary discontinuance or from dismissal for failure or neglect to prosecute.

(4) This section does not alter the law on tolling of the statute of limitations nor does it apply to causes of action which have accrued before this Act becomes effective.

period for the bringing of an action for breach of a contract of sale. The section also contains a number of subsidiary provisions with respect to the following matters: the parties' right to restrict but not to extend the statutory period; the time when a cause of action accrues for the purpose of the section; and, the extension of the period of limitation when an action commenced within the limitation period is terminated and the plaintiff seeks to bring a new action for the same breach.

The desirability of a separate limitation period for actions arising out of contracts of sale was considered by the Commission in its earlier *Report on Limitation of Actions*.<sup>12</sup> In particular, we considered whether the limitation period should be reduced from 6 to 4 years as suggested by UCC 2-725(1). We rejected such a reduction<sup>13</sup> on the grounds that we did not think the benefit to the commercial community would be so significant as to justify a change to the shorter period, and because the six year period for actions in contract was well known and established in Ontario and other common law jurisdictions. In our view, both reasons remain valid and, accordingly, we recommend no change in the current position.

In 1974 a United Nations Conference adopted a *Convention on the Limitation Period in the International Sale of Goods* drafted by UNCTRAL.<sup>14</sup> This Convention provides for a limitation period of four years in international contracts for the sale of goods and, if adopted by the federal government at the request of Ontario,<sup>15</sup> would introduce an important distinction in Ontario between contracts subject to the Ontario Limitations Act and those subject to the shorter period stipulated in the Convention. An amendment to the *Uniform Limitation of Actions Act* was approved in 1976 by the Uniform Law Conference,<sup>16</sup> with a view to encouraging the uniform extension of the Convention to the Provinces through an appropriate declaration by the federal government, if Canada should decide to accede to the Convention. Our opinion has not been sought with respect to whether Ontario should make such a request to the federal government, and we express no view on the desirability of such a step.

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<sup>12</sup>*Supra*, footnote 5, pp. 32-34.

<sup>13</sup>*Ibid.*, p. 34.

<sup>14</sup>See, *Proceedings of the 57th Annual Meeting of the Uniform Law Conference of Canada* (1975), Appendix M, pp. 160-61; *Official Records of the United Nations Conference on Prescription (Limitation) in the International Sale of Goods* (U.N. Pub., Sales No. E. 74. V.8), p. 101.

<sup>15</sup>The Convention, in Art. 31, contains a 'federal state' clause to accommodate the interests of federal states, like Canada, when the subject matter of the Convention falls constitutionally within the jurisdiction of the Provinces. In such cases, the Convention will only apply in respect of those Provinces that have made such a request, and where a declaration to this effect has been made by the Canadian government at the time of acceding to the Convention or subsequent thereto.

<sup>16</sup>*Proceedings of the 58th Annual Meeting of the Uniform Law Conference* (1976), at p. 29, and Appendix L, pp. 146 *et seq.* A revised Uniform Act is currently under consideration by the Conference.

### 3. CONFLICT OF LAWS PROVISIONS

When a contract of sale contains a foreign element, the question may arise whether Ontario law or some other law governs the contract or some particular aspect of it. The rules that determine this question belong to that branch of the law known as the conflict of laws or, less accurately, in the North American context, private international law. The foreign element may be introduced<sup>17</sup> in a number of ways: one of the contracting parties may reside or carry on business outside Ontario; the contract of sale may have been concluded, or may be intended to be performed, in whole or in part, outside the Province; or, the goods that are the subject of the sale may be located elsewhere.

Given the frequency and importance of interprovincial and international sales to the Ontario economy — and, of course, to the Canadian economy as a whole — we have considered the desirability of adding some conflict of laws provisions to the revised Sale of Goods Act. We have concluded, however, that this should not be done, and our Draft Bill contains no such provisions.<sup>18</sup>

Our reasons are as follows. First, whatever their theoretical importance, conflict of laws issues are not often raised in practice in sales litigation,<sup>19</sup> and we anticipate no significant change in this respect in the foreseeable future. Secondly, the existing Sale of Goods Act contains no conflict of laws provisions, and their absence does not appear to have created any appreciable difficulties. Thirdly, the applicable conflict of laws rules are not peculiar to contracts of sale; if it were thought desirable to codify these rules, it would be better to do so in a wider context involving the law of contract at large, or at least all commercial contracts. Finally, and most importantly, it would be far from easy to draft a satisfactory, comprehensive, and useful set of rules. Conflict of laws rules in the contractual area are predominantly of judicial origin. Many of them are still in the course of evolution, or are flexible in character.<sup>20</sup> An attempt to codify could therefore result in a premature freezing of the rules, or in rules so vague — such as the rule that the parties' obligations under a contract of sale are governed, in the absence of an express choice of law clause, by "the proper law" of the contract<sup>21</sup> — as to be of very limited assistance in the resolution of actual disputes.

<sup>17</sup>Compare, *Benjamin's Sale of Goods* (1974), ch. 26.

<sup>18</sup>Our present concern is with choice of law rules and not with rules concerning the jurisdiction of Ontario courts over a defendant who is outside Ontario. Such jurisdictional questions are covered in the rules of practice. See, Rules 25-31 of the Supreme Court of Ontario Rules of Practice, R.R.O. 1970, Reg. 545, as am.

<sup>19</sup>The position appears to be the same in the United Kingdom. See, *Benjamin's Sale of Goods* (1974), para. 2291, p. 1159. As Benjamin notes, foreign law must be pleaded and proved as a fact before a court is required to take notice of it. Since frequently it is not pleaded, even though a foreign element is present, the conflict of laws issues are never resolved and the court only applies its own domestic law.

<sup>20</sup>Compare, *Benjamin's Sale of Goods* (1974), ch. 26; Castel, *Canadian Conflict of Laws* (1977), Vol. 2, ch. 19.

<sup>21</sup>See, for example, *Etler v. Kertesz*, [1960] O.R. 672 (C.A.), and the earlier Canadian authorities cited in Castel, footnote 20 *supra*, at p. 516, n. 12.

#### 4. TRANSITIONAL PROVISIONS

Under this heading we discuss the question of the extent to which the revised Sale of Goods Act should apply to contracts of sale concluded, but not fully executed, before the operative date of the new Act. The general rule of construction is<sup>22</sup> that a statute is not retrospective in character. Accordingly, unless the revised Act provided otherwise, the Act would not apply to contracts of sale concluded before the Act comes into effect.

We are of the view that the revised Act should not be made retrospective, since to do so could prejudice unfairly rights and obligations bargained for in reliance on, or otherwise accruing under, the older law. It could be argued that this would not be true of all the provisions in the revised Act, and that a substantial number of them could usefully be applied to existing contracts without interfering with accrued rights or obligations.<sup>23</sup> While recognizing the force of this reasoning, we would prefer that a simple rule govern the applicability of the new Act. We would not favour a rule that distinguishes between the provisions of the revised Act, applying some of them to existing contracts of sale, but not others. Most contracts of sale are of a relatively short duration. The new Act could, therefore, be expected to capture a great majority of sales transactions within a short period after the Act comes into force. In addition, the courts would be free to apply by analogy some of the new rules to existing contracts, where they felt it appropriate to do so.<sup>24</sup>

In the light of the foregoing comments, we recommend that the revised Act should contain provisions to the following effect:

- (a) that the Act shall apply to contracts of sale and other transactions governed by the Act that are entered into on or after the day on which the Act comes into force;<sup>25</sup> and,
- (b) that the existing Sale of Goods Act should be repealed except for contracts of sale entered into before the day on which the revised Act comes into force.<sup>26</sup>

#### 5. CONFLICTING LEGISLATION

In previous chapters of this Report,<sup>27</sup> we have drawn attention to the substantial body of legislation, apart from *The Sale of Goods Act*, that affects all or some types of contract of sale. In a number of instances we have made specific recommendations, either to avoid a fairly obvious conflict between other legislation and the revised Sale of Goods Act, or

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<sup>22</sup>*Craies on Statute Law* (7th ed., 1971), pp. 387 *et seq.*

<sup>23</sup>This would be particularly true of those provisions that are designed to clarify rather than to change the existing law.

<sup>24</sup>In the U.S., some courts used the analogical route in applying or referring to the provisions in Article 2 of the *Uniform Commercial Code* before the Code had been adopted in their jurisdictions.

<sup>25</sup>See, Draft Bill, s. 10.1.

<sup>26</sup>See, Draft Bill, s. 10.2.

<sup>27</sup>See, in particular, *supra*, ch. 2, sec. 2.

to bring other legislation into conformity with the principles of the revised Act.

We have not made an exhaustive inventory of all the provincial statutes that may give rise to a conflict with the revised Act. We have, however, considered the question whether the revised Act should contain a provision to the effect that, in the event of a conflict between the revised Act and any other legislation, the revised Act should prevail. In our view, such a provision has more potential for harm than for good, and we do not recommend its adoption.

Our reasons are as follows. The general rule of construction is<sup>28</sup> that a later Act does not repeal an earlier Act covering the same subject matter, not being of a special character, unless there is a clear conflict between the two. To this extent, the suggested section in the revised Act would merely restate the existing law. It would not, however, be helpful, since it would not assist the courts in determining whether a conflict in fact exists — and this is usually the most difficult question. On the other hand, the proposed section would go too far, insofar as it might dictate the primacy of the provisions of the revised Act, whether or not the earlier legislation was of a special character (and thus otherwise subject to the *prima facie* rule that general legislation does not derogate from special legislation),<sup>29</sup> and regardless of its purpose. This could have serious consequences for such consumer protection legislation as *The Consumer Protection Act*<sup>30</sup> and *The Business Practices Act*<sup>31</sup> and could also bring the proposed section into conflict with provisions such as section 45 of *The Consumer Protection Act*. To avoid these and similar difficulties, the proposed section would have to exclude these types of Act specifically; but even then there is always the possibility that a relevant Act might be overlooked.

It will be seen, therefore, that there is no simple formula for resolving statutorily a potential conflict between the revised Act and other legislation. There are two realistic alternatives. Such conflicts might be left to be resolved in accordance with the normal rules of statutory construction. This is commonly the case in Ontario with legislation of a general character. Alternatively, the revised Act could adopt much more detailed rules of construction than the simple provision to which we have referred. In our opinion, the first solution would be simpler. Accordingly, we recommend that the revised Act should contain no general constructional rules. It should be clearly understood, however, that this recommendation is not intended to affect the specific recommendations contained in earlier chapters with respect to the avoidance of conflict between the revised Sale of Goods Act and other legislation, or the promotion of greater harmonization between the two. Nor is it intended to preclude additional efforts to identify other potential points of conflict and their appropriate resolution.

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<sup>28</sup>*Craies on Statute Law* (7th ed., 1971), pp. 371 *et seq.*

<sup>29</sup>*Ibid.*, pp. 377-78; *Seward v. Vera Cruz* (1881), 10 A.C. 59 (H.L.).

<sup>30</sup>R.S.O. 1970, c. 82, as am.

<sup>31</sup>S.O. 1974, c. 131.

**RECOMMENDATIONS**

The Commission makes the following recommendations:

1. The Crown should be bound by the provisions of the proposed revised Sale of Goods Act.
2. Actions involving contracts of sale should not be subject to a special limitation period; a provision comparable to UCC 2-725 should not be adopted in the revised Ontario Act.
3. The revised Act should not contain any conflict of laws provisions.
4. The revised Act should only apply to contracts of sale and other transactions to which the Act applies that are entered into on or after the day on which the Act comes into force.
5. The existing Sale of Goods Act should be repealed except for contracts of sale entered into before the day on which the Act comes into force.
6. The revised Act should contain no general provisions with respect to the resolution of any conflict between the revised Act and any other legislation; rather, such conflicts should be resolved according to the normal rules of statutory construction.

## CONCLUSION

This Reference has been a most difficult and taxing one for the Commission — the most difficult experienced during its fifteen years. In few areas is the law more complex; solutions to the almost infinite variety of problems are neither easy nor immediately apparent. The fact that this Report indicates some dissents in special areas by Members of the Commission illustrates the difficulty of reaching satisfactory conclusions and recommendations.

Earlier in our Report<sup>1</sup> we have emphasized the desirability of involving the Uniform Law Conference in recommending to the common law Canadian jurisdictions a revised and uniform Sale of Goods Act. Our hope is that the draft Act that we have prepared may become the basis of such a Uniform Act in the early future. However, we do not suggest that Ontario await uniformity before dealing with our recommendations.

We renew our expression of gratitude to the Research Director, Professor Jacob S. Ziegel, and to his colleagues on the Research Team. Professor Ziegel has invested an immense amount of his talent, unexcelled knowledge and scholarship as well as his time over a period of several years. Our gratitude to him is so great as to be immeasurable. Nevertheless, we absolve him from responsibility for any recommendations. We are aware — indeed, vividly aware — from his vigorous presentation of his opinions, that there are a number (fortunately only a few) of our recommendations in which he would be hesitant to concur.

In the preparation of the Draft Bill, the Commission has had the benefit of the great skill and long experience of Mr. L. R. MacTavish, Q.C., former Senior Legislative Counsel. The attempt to preserve as much of the actual language of the *Uniform Commercial Code* (so that American interpretative jurisprudence might be available to us) while adapting it to the practices and style of Ontario drafting has been a most difficult task. We are deeply grateful to Mr. MacTavish for his exceptional services but hasten to acquit him of any responsibility for the attempted “drafting marriage”.

Much of the work of research for the preparation of this Report was undertaken when Dr. H. Allan Leal, Q.C., was Chairman of the Commission. We acknowledge our major indebtedness to him but absolve him also from any association with or concurrence in our recommendations.

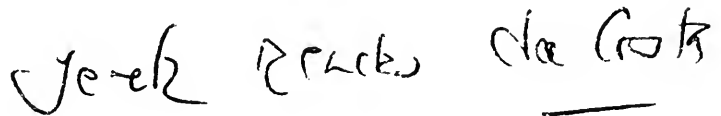
The Vice Chairman and other Commissioners wish to record the fact that the final preparation of this Report has involved unusual labours on the part of our Chairman and of our Counsel. Dr. D. Mendes da Costa, Q.C. and Ms. M. P. Richardson have demonstrated their very special dedication to the cause of law reform and have earned the deep gratitude of their colleagues. We would also wish to acknowledge with gratitude the special efforts of two of our Legal Research Officers, Ms. J. K. Bankier,

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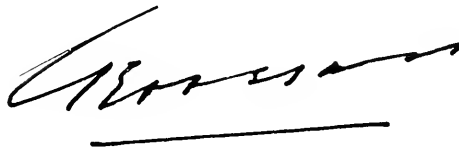
<sup>1</sup>*Supra*, ch. 2, pp. 10-11, and ch. 3, p. 30.

and Mr. W. A. Bogart, and of Miss A. F. Chute, Secretary to the Commission.

All of which is respectfully submitted.



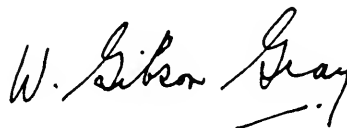
DEREK MENDES DA COSTA, *Chairman*



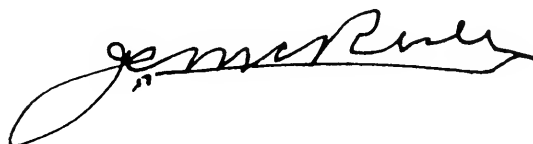
GEORGE A. GALE, *Vice Chairman*



RICHARD A. BELL, *Commissioner*



W. GIBSON GRAY, *Commissioner*



JAMES C. McRUER, *Commissioner*



WILLIAM R. POOLE, *Commissioner*

March 30, 1979



